COMMONWEALTH OF MASSACHUSETTS

DEPARTMENT OF PUBLIC UTILITIES

INVESTIGATION BY THE DEPARTMENT ON ITS OWN MOTION INTO THE PETITION OF BOSTON GAS COMPANY FOR AN INCREASE IN ANNUAL REVENUES OF $30 MILLION, APPROVAL OF A PRICE-CAP PLAN TO 96-50 IMPLEMENT PERFORMANCE-BASED REGULATION, APPROVAL TO UNBUNDLE ITS GAS SALES AND TRANSPORTATION SERVICES OVER A FOUR-YEAR PERIOD, AND APPROVAL OF THE COMPANY'S PLAN TO EXIT THE MERCHANT FUNCTION BY THE YEAR 2000	)	D.P.U.

MOTION FOR RECONSIDERATION, CLARIFICATION AND RECALCULATION OF BOSTON GAS COMPANY

Catherine L.

Nesser

Thomas P. O'Neill
Jeffrey M. Leupold
Boston Gas

Company

One Beacon Street
Boston,

Massachusetts 02108

(617) 742-8400

James K. Brown
Foley, Hoag &

Eliot

One Post Office
Square
Boston,
Massachusetts 02109
(617) 832-1000

December 19, 1996

TABLE OF CONTENTS

MOTION FOR RECONSIDERATION, CLARIFICATION, AND RECALCULATION OF BOSTON GAS COMPANY

I. Introduction and Standard of Review

On November 29, 1996, the Department of Public Utilities ("Department") issued its order in Phase I of this proceeding ("Order"). In its Order, the Department, inter alia: (1) allowed Boston Gas Company ("Boston Gas" or "Company") a revenue increase of $6.3 million; (2) approved a five-year performance based regulatory plan to commence November 1, 1997; and (3) approved unbundled transportation tariffs and an interim capacity assignment program.

The Department's standard of review for motions for reconsideration and clarification is well established. The Department has stated that it grants reconsideration of its orders when "extraordinary circumstances dictate that we take a fresh look at the record." In submitting a motion for reconsideration, the movant should present previously unknown or undisclosed facts that would have a significant impact upon the decision rendered. Boston Edison Company, D.P.U. 90-270-A, pp. 2-3 (1991). In addition, the Department reconsiders its decisions when its disposition of an issue was arguably the result of inadvertence or mistake. New England Telephone, D.P.U. 89-300-I, pp. 4-5 (1990). The Department has held that clarification is granted when an order is silent or ambiguous on an issue, or if further explanation is warranted. Boston Edison Company, D.P.U. 90-270-A, pp. 2-4. The Department routinely grants motions for recalculation to rectify demonstrated calculation errors. Massachusetts Electric Company, D.P.U. 95-40-C, p. 2 (1995).

In addition, although the Department has broad authority over the rates and charges of gas utilities pursuant to G.L. ch. 164, the Department's powers are bounded by certain legal principles. The most fundamental of these is that the rates it establishes must compensate investors for the risks of their investment, and be sufficient to attract capital and assure confidence in the utility's financial position. Anything less is confiscatory. Federal Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591 (1942); Bluefield Water Works and Improvement Co. v. Public Serv. Comm'n of West Virginia, 262 U.S. 679 (1923); Fitchburg Gas and Elec. Light Co. v. Department of Public Utilities, 371 Mass. 881, 884 (1977). If a utility asserts that the rates set by the Department are confiscatory, the Supreme Judicial Court has stated that the utility "is entitled to an independent review of law and facts," and that the reviewing court has "authority to require the production of 'new evidence necessary to bring the proof as nearly as reasonably possible down to the date of final decision.'" Boston Edison Co. v. Department of Public Utilities, 375 Mass. 1,9 (1978) (quoting from Opinion of the Justices, 328 Mass. 679, 687 (1952)), Aff'd, New England Tel. and Tel. Co. v. Department of Public Utilities, 371 Mass. 67, 71-72 (1976). Finally, "where no allowance is made by other means for demonstrated attrition of a utility's economic ability to earn a fair return, a fair return must include an allowance in excess of the utility's cost of capital." Boston Gas Co. v. Department of Public Utilities, 359 Mass. 292, 307 (1971).

In addition to these fundamental constitutional rights, the Court has also made it clear that "a party to a proceeding before a regulatory agency such as the Department has a right to expect and obtain reasoned consistency in the agency's decision." Boston Gas Co. v. Department of Public Utilities, 367 Mass. 92, 104 (1975). A year later, the Court expanded on that principle, stating that "when a major change in the regulatory standard is in prospect, there should ordinarily be warning to enable the Company to adjust both its practices and proof to the new situation." New England Tel. and Tel. Co. v. Department of Public Utilities, 371 Mass. 67, 84 (1976).

As discussed in this petition, these three principles -- the bar on confiscation, "consistent treatment" and "prior notice" -- have particular significance in regard to several aspects of the Department's cost of service and PBR determinations in this case. A related principle is also germane, particularly with respect to the Department's decision to reverse its prior order authorizing the Company to phase in the rate recovery for its outstanding PBOP obligations. Thus, in a case involving the Company's predecessor, the Court stated that utilities "may shape their conduct in accordance with [a final Order of the Department], secure in the reliance that it may not be changed to their disadvantage even under the guise of interpretation . . . ." Boston Consol. Gas Co. v. Department of Public Utilities, 321 Mass. 259, 265 (1947).

Finally, G.L. c. 30A, § 14 states that the Department's orders are subject to appeal if they are unconstitutional, in excess of the Department's statutory authority, based on an error of law or unlawful procedure, unsupported by substantial evidence, or are arbitrary, capricious, or constitute an abuse of discretion.

Given the momentous impact of this Order on the Company’s operations over the next six years, Boston Gas has carefully reviewed the Order and considered the Department's findings. The Company hereby moves the Department to reconsider, clarify, and recalculate the findings in its Order as stated herein. Most important, the Department must reconsider its findings on the allowed base rate revenue increase which, coupled with the performance based regulatory ("PBR") plan, provides for confiscatory rates, and denies the Company any opportunity to earn the allowed rate of return. The Company presents with this Motion new evidence and demonstrates of the inadvertent results created by the Department's Order that warrant and necessitate the Department's close attention and reconsideration.

The Company submits with this Motion the Reconsideration Testimony of the following witnesses: Chester R. Messer, President of Boston Gas Company; Robert M. Miller, Vice President Operations & Marketing Support; Rebecca S. Bachelder, Manager of Rates; Dr. Mark Newton Lowry, Vice President of Christensen Associates; Jane M. Kelly, Director of Accounting; and William T. Yardley, Manager of Gas Acquisition & System Control. Shortly hereafter, the Company will also submit the testimony of J. Atwood Ives, Chairman of the Board and Chief Executive Officer of Eastern Enterprises, and Paul Murphy, Managing Director of Salomon Brothers, Inc. The Company requests that this testimony be allowed in the record of this proceeding and that the Department allow these witnesses to be heard. Although the Company recognizes that it is unusual for the Department to entertain additional testimony and to conduct a hearing upon a motion for reconsideration, the complexity of this proceeding and the profound impact of the Order on the Company's operations over the next six years are also unprecedented, and warrant the Department's accommodating the Company in this request.

II. <u>The Order Assures Escalating Revenue Deficiencies Over the Six Years of the PBR Plan That Will Jeopardize The Company's Financial Position</u>.

The Company understands, appreciates, and agrees with the Department's clear objective of reducing energy costs. The Company's concurrence with this objective, and with the Department's previously articulated goal of introducing competitive discipline to all aspects of utility regulation, is what drove the Company's comprehensive PBR and unbundling proposals, preceded by a reengineering effort to prepare it for a restructured environment. It remains the Company's belief that a regulatory structure that includes fair and compensatory cast-off rates, a balanced and well-designed PBR plan, and comprehensive service unbundling that promotes and preserves customer choices is the best means of controlling and reducing energy costs and facilitating competition.

However, pursuit of lower energy costs must be balanced with preservation of the financial health of regulated, capital intensive energy distribution companies. As a critical link in the energy chain, the local distribution company must remain a viable entity capable of attracting the extensive capital required to maintain safe and reliable operations. If it cannot, then the benefits of lower prices and increased choices otherwise attainable from rate and service restructuring will not materialize. The Department approved the Company's basic proposal for service unbundling and capacity assignment for commercial and industrial customers on an interim basis, presumably to afford customers the opportunity to benefit from a competitive energy market that the Company has sought to promote. However, the cast-off rates and PBR plan approved by the Department place the Company in financial distress, the cost of which will soon overtake any benefits achievable from these unbundling initiatives.

In pursuit of its interest in lowering energy costs for customers, the Department mistakenly disallowed from the Company's base rates costs that it found to be prudently incurred and that should have been allowed consistent with Department precedent. Thus, the Company will begin the rate year with a revenue deficiency. Further, the Department approved a five year PBR plan and Service Quality mechanism that set unattainable performance targets for the Company to achieve average financial performance, while purporting to preclude the Company from seeking rate relief for the duration of the plan. Left untouched, the compound effect of these components of the Order will place the Company in an attenuated financial position as soon as 1997, which will deteriorate with each subsequent year of the plan.

In his Reconsideration Testimony, the Company's president, Chester R. Messer, discusses the impacts of the Order and the implications on the Company's operations over the next six years, impacts and implications that were surely not intended by the Department. These impacts are summarized in the following table, sponsored in Mr. Messer's testimony (Exh. BGC-246), which documents the Company's projected return on equity under the Order in the rate year and the ensuing five years of the PBR plan:

Year	Return on Average Common Equity

1997	8.8%
1998	7.5%
1999	6.7%
2000	6.1%
2001	5.5%
2002	5.3%

As shown above, the Company's rate of return on common equity over the PBR period rapidly deteriorates to unacceptable levels. Mr. Messer identifies the assumptions underlying these figures in Exh. BGC-246. In fact, the returns on equity shown are on the high side, given the conservative assumptions made. For example, it is assumed that the Company incurs no penalties for failures to meet Service Quality performance targets. The assumed growth rate is an aggressive projection that is only achievable if the Company can raise substantial amounts of outside capital, and increase marketing spending by $2 million per year. The Company cannot survive with these inadequate, shrinking returns.

Mr. Messer illustrates the devil's dilemma that the economic aspects of the Order inadvertently have created. To earn the 11% return on equity allowed by the Order, the Company would have to cut costs or increase sales margin beyond forecast growth by an annual average exceeding $5 million. Exh. BGC-246. In terms of sales growth, this would require annual growth far in excess of the Company's projected rate of 2.3 Bcf, which is aggressive in light of the Company's actual average growth rate of 1.6 Bcf per year for the past five years. There is no market data or economic basis for believing that the Company could grow at a more aggressive rate, even if it had no difficulty attracting low cost capital to finance growth. Nor is it possible to eliminate $5 million in costs on a recurring basis in every year without severely compromising the Company's ability to maintain very basic service to customers and the safety and reliability of its distribution system.

Mr. Messer points out that of the Company's controllable costs, $93 million, or 65 percent, is labor related. The bulk of the costs in the remaining 35 percent necessary for the growth and maintenance of system infrastructure and to provide service to customers. Therefore, the Company cannot earn an average return without eliminating jobs. To achieve the 11 percent return on equity allowed by the Department, Mr. Messer would have to eliminate 90 jobs per year, or almost 40 percent of the work force by the end of the PBR plan. Given that the Company has already eliminated 120 jobs through its QUEST initiatives, Mr. Messer states that the Company cannot further reduce its work force enough to attain adequate earnings and still maintain the safety of its operations. Thus, the Company has no opportunity to generate adequate returns.

As noted by Mr. Messer, although the Company's financial health will be dependent on unprecedented growth, the Company's opportunity to grow has been thwarted by the combined effect of the inadequate cast-off rates and the PBR formula that essentially freezes those rates for six years. Earnings will likely further erode as a result of the stiff Service Quality penalties. As it stands, the Company will be stretched to the breaking point to invest the planned $33 million per year to replace and maintain its aging distribution system, the second oldest in the United States, and to continue providing service to its customers. Growth -- funded by discretionary investments -- will be severely limited. If the

Company cannot attract capital to grow, it will not grow.

The implications of the Company's inability to attract competitively priced capital will ripple through the economy. If gas is not available to support the needs of an expanding local economy, either there will be less expansion or businesses will turn to other fuels. As natural gas is the cleanest burning fossil fuel, the Commonwealth's efforts to reduce NOX and particulate emissions will suffer accordingly.

Unless the Department remedies the confiscatory effects of the non-compensatory base rates and the PBR plan that denies the Company any opportunity to earn an adequate return on investment, the Company will have no choice but to withdraw its PBR plan. Moreover, Mr. Messer states that the Company will defer its proposals for Phase II of this proceeding, pending the final outcome of this Motion and any subsequent appeal. The Company is rethinking its future business plans, which will depend on the outcome of this process. The Company is prepared to be subject to competitive discipline, and is committed to succeeding under a PBR plan that provides a fair opportunity to earn adequate returns. The compound effect of the Department's base rates and PBR plan denies this opportunity.

Although the economic findings of the Department's Order will succeed in reducing rates for customers in the present heating season, the longer term impacts of the Order will adversely affect all industry participants, investors, and, ultimately, customers. These inadvertent results of the Order will be discussed by Mr. Ives and Mr. Murphy in their testimony. Mr. Ives will discuss the prospects for Eastern's continued investment in the Company, as well as future investments to consolidate the industry. Mr. Murphy will describe the unintended but likely adverse impacts on the Company's cost of capital.

In its Order, the Department appears to have lost sight of the delicate balance that PBR must achieve by simultaneously enhancing competition, rewarding superior performance and safeguarding system integrity, in addition to promoting price benefits for customers. D.P.U. 94-158. In the case of Boston Gas, the PBR plan upsets the balance, as the Company has been unfairly weighted by the 2.0 percent X factor. Customers are awarded all past and potential benefits from the Company's reengineering efforts, yet the Company has no chance for any sort of reward regardless of how well it performs, and its ability to maintain the integrity of its system is seriously challenged.

In sum, although the Order may appear to have salubrious effects in the current heating season, the result is to bring the Company to its knees, starved for capital. Negative impacts will flow to other industry participants, and, in the end, will land on customer bills. The potential benefits available from a flourishing, competitive natural gas market will be consumed and reversed at the city gate. This could not be the result the Department intended.

III. On Reconsideration, the Department Should Approve Each and Every Component of the Offer of Partial Settlement filed on November 15, 1996.

On November 15, 1996, an Offer of Partial Settlement (the "Settlement") was jointly sponsored by the Company, the Attorney General, the Division of Energy Resources ("DOER"), The Energy Consortium ("TEC"), Associated Industries of Massachusetts ("AIM"), and the Low-Income Intervenors, represented by the National Consumer Law Center ("Low-Income Intervenors"). The Settlement resolved: (1) all issues relating to the Company's request for additional base rate revenues, including a rate of return on common equity; (2) all issues regarding the financial assistance rate discount; (3) the ratemaking treatment of interruptible local transportation ("IT") margins; (4) certain issues regarding pricing of IT service; (5) certain issues relative to demand-side management spending; (6) the effective date of the Company's initial compliance filing under any performance-based regulatory plan approved by the Department; (7) all issues regarding cost allocation; (8) the customer charges for the period December 1, 1996 through November 1, 1997; and (9) the rate design for Rate Schedules G-44, G-45, G-54 and G-55. In the parties' Joint Motion For Approval of the Settlement, Boston Gas offered to make witnesses available to respond to any questions the Department had regarding the Settlement, whether in writing or orally at a hearing. On November 18, 1996, the Department solicited comments on the Settlement from all parties to the proceeding. Of the 33 intervenors with full party status, only one, The Marketing Group ("TMG"), chose to comment, and did so in support of the Settlement. (TMG Letter dated November 21, 1996). The Department did not issue written questions, nor did it hold a hearing on the Settlement.

In its Order, the Department summarily rejected the Settlement, saying only that it did "not serve the interest of ratepayers". Order, p. 8. The Department should reconsider this finding based on evidence that was not in the record but which accompanies this Motion that demonstrates the rationale of the Settlement and why the Company's ratepayers, through their designated representatives who participated in a six month mediation process and actively negotiated the Settlement, determined that it did serve their interests. While the consensus of interested parties is not a substitute for the Department's judgment as to the interest of ratepayers, the Department must give due consideration to the reasons underlying a broad-based consensus in which all ratepayers are represented.

A. <u>The Settlement Was Crafted By the Parties as a Package to Tie the Company's Base Rate Revenues, IT pricing, and the Ratemaking Treatment For IT Service</u>.

As noted above, the Settlement resolved among the parties the Company's base rate revenues, a fixed price IT service option, and the ratemaking treatment for IT revenues, *inter alia*.[1] In its Order, the Department dismembered this critical portion of the Settlement by cutting the Company's base rate revenue increase agreed upon by all parties to the Settlement by 52 percent, deferring for Phase II the issue of a fixed price IT option, and rejecting the ratemaking treatment for IT revenue provided for in the Settlement in favor of the 75%-25% sharing mechanism that is the status quo.

As is the case with any negotiation, the parties to the Settlement engaged in trade offs to arrive at a resolution that was agreeable to all, and included in the Settlement those issues that needed to be addressed to achieve consensus. It was not a coincidence that the Settlement addressed the Company's base rate revenues, interruptible transportation pricing and the ratemaking treatment for interruptible transportation service revenue as a package deal, and that the

[1] The Company notes that the Settlement, if approved, would create neither policy nor precedent. It would bind Boston Gas only to file conforming tariffs, and such tariffs would be subject to a subsequent Department order affecting them.

parties agreed that the settled issues were not to be severed. The Company may have been remiss in not explicitly documenting for the Department how these items interrelated when it filed the Settlement. The Company wishes to correct that oversight now, and explain why these portions of the Settlement simply cannot be severed.

As discussed in Section IV, *infra*, all parties to the Settlement had an interest in seeing that the Company had adequate base rate revenues to compensate it for known and measurable costs, and to assure that the Company could attract capital at reasonable rates going into a six year performance-based regulatory plan. The parties to the Settlement also recognized that offering a fixed price IT service option, which was of paramount interest to TEC, AIM, U.S. Gypsum and DOER, and supported by the Attorney General,[2] would place the Company at risk of revenue erosion as existing firm customers migrated to the fixed price IT service option.

This risk of revenue erosion, which was an essential underpinning of the Settlement but was not a matter of record for the Department's deliberations on the Order, is discussed in the Reconsideration Testimony of Rebecca S. Bachelder accompanying this Motion. As noted by Ms. Bachelder, it is highly probable that existing firm, known dual-fuel customers will migrate to the fixed-price IT option. Many of these customers were former interruptible sales customers who selected firm transportation when that service became available following the Department's order in D.P.U. 93-60. These customers migrated to firm transportation because that service, combined with third-party gas, was

[2] Order, pp. 197-199.

more economical than interruptible service priced on a value of service basis. These are customers who understand and readily accept the risk of interruption. Known dual-fuel customers alone represent a minimum revenue loss of $2 million, potentially as great as $4 million. Moreover, this does not include customers who have dual-fuel capability without the Company's knowledge. Nor does it include those commercial and industrial customers who do not have dual-fuel capability, but who may decide to assume the risk of service interruption under IT service to take advantage of an attractive fixed price.[3] Because this incremental risk relates in part to customer attitude, it is difficult to quantify. The risk of firm revenue erosion figured prominently in the negotiations leading to the Settlement.

Together, the base rate revenue and IT margin retention points of the Settlement allow the Company the wherewithal to shoulder the risk of offering an attractive, fixed-price IT option for commercial and industrial customers. It also provides positive incentives for the Company to increase throughput or be at risk of further revenue loss. This type of incentive is fully consistent with the move to a competitive gas market and also complements the Commonwealth's objective of reducing NOX and particulate emissions. The adjustments discussed in Section IV and supported by Ms. Kelly demonstrate the reasonableness of the economic aspects of the Settlement.

B. By Severing and Modifying the Components of the Settlement, the Department Inadvertently Eliminated the Company's Ability to Offer a Fixed-Price IT Option.

---

[3] It is not unlikely that some of these customers will do so, especially given that the Company generally has not interrupted service to IT customers in the off-peak months, and has straightforwardly advised the Department that there is usually no operational reason for interrupting local distribution to most IT customers. D.P.U. 93-141-A, p. 41, n. 20.

In rejecting the Company's proposed buy-out of the IT market, the Department stated that this was premature, given the Notice of Proposed Rulemaking ("NOPR") on eliminating the maximum rate cap on released pipeline capacity pending before the Federal Energy Regulatory Commission ("FERC"),[4] and the impact that proceeding may have on access to IT service. Order, p. 196. It is unclear to the Company what impact the NOPR might have on access to local distribution service. If there is any impact at all, it would be to destabilize energy prices even further, thereby arguing in favor of a fixed rate IT option. In any event, since the record of this proceeding closed, FERC issued its order launching the 1996/97 pilot program, rejecting the Company's application (and all but five others) to participate. It is evident from FERC's order that elimination of the price cap on released capacity is not imminent, and is most unlikely to occur in the near future. Secondary Market Transactions on Interstate Pipeline Companies, 77 FERC ¶ 61,183.

There will never be certainty as to the level of IT margins. As the Department recently recognized in D.P.U. 93-141-A, the volume of IT service is closely tied to the pricing of unregulated fuel oil. D.P.U. 93-141-A, p. 40. The Company's proposed buy-out of the IT market, accepted and accounted for in the Settlement, is consistent with the Department's directives to gas utilities in that Order to propose broad-based incentives for IT service revenue. Id., pp. 12-13. There can be no change in IT pricing policy unless corresponding

---

[4] Secondary Market Transactions on Interstate Natural Gas Pipelines, Notice of Proposed Rulemaking, 61 Fed. Reg. 41,046 (1996).

adjustments are made to base rates and IT ratemaking treatment. Nothing has changed since the D.P.U. 93-141-A Order to alter the appropriateness of that directive.

As its basis for deferring consideration of the issue of IT pricing for Phase II of this proceeding, the Department cites again to the pending NOPR at FERC and to its own disposition of the capacity assignment issue in Phase II. Order, p. 200. Although these issues relate to two necessary components of unbundled service, the Department does not elaborate on why IT pricing should be contingent on the outcome of the capacity assignment issue.

What is clear from the Reconsideration Testimony and Exhibits of Rebecca S. Bachelder is that, unless the Department has decided that the value of service pricing method is the only appropriate method of pricing IT, the IT pricing issue cannot be decided apart from the Company’s base revenue requirements and IT ratemaking treatment. To do so would place the Company at risk of revenue erosion with no opportunity to recoup its losses. This would “guarantee a substantial future revenue deficiency,” the very result the Department explicitly sought to avoid in declining to approve the Company’s proposed ratemaking treatment for IT. Order, p. 196.

V. <u>Cost of Service</u>

As Ms. Kelly demonstrates in her Reconsideration Testimony, the Department made both legal and mathematical errors in computing the Company's cost of service. Exh. BGC-264. These errors seriously understate the Company's revenue requirements and, unless they are corrected, will impair its ability to deliver quality service and survive in a performance-based regulatory environment. In addition to the disallowance of prudently incurred test year costs, in ordering that the Company’s PBR plan not commence until November 1, 1997, one year after the Company’s proposed implementation date, the Department neglected to include in rate base certain post-test year costs, thereby aggravating the Company’s revenue deficiency at the cast-off point. Indeed, as matters now stand, the rates are confiscatory. As outlined below, and as described in more detail in Ms. Kelly's testimony, the Company requests the Department to reconsider the following aspects of the cost of service portion of the Order: the Department's decision to exclude 1996 investments in system renewal and information technology from rate base and the associated depreciation/amortization expense; the determination that the Company's cost of equity is 11.0 percent; and the expense allowances relating to (i) union wages, (ii) non-union salaries, (iii) FICA taxes, (iv) overtime, (v) QUEST payroll taxes (vi) bad debts, (vii) cellular telephones, (viii) rate case expense, (ix) the amortization period for QUEST costs, (x) pensions, (xi) PBOPs, and (xii) property taxes.

The following is a summary of the items the Company requests the Department to reconsider and their impact on the Company’s revenue requirements:

Cost of Service - Items for Reconsideration

Item	Rate Base Impact	Revenue Impact
Rate Base:		
1996 System Renewal Investments	28,056,000	
1996 Performance Measurement Systems	1,582,000	
Total Rate Base Additions	29,638,000	
Less: Deferred Taxes	(1,200,118)	
Less: 1996 Depreciation Expense	(20,215,031)	
Net Rate Base Increase	8,222,851	
Return on Rate Base at 9.38%		771,303
Applicable Federal & State Income Tax		298,789
Expenses:		
1997 Union wage increase (1/2 year)		911,069
1997 Management salary increase		1,024,800
1997 FICA tax increase		167,807
Overtime normalization		2,133,597
QUEST payroll tax error		8,952
Bad Debts - CGAC recovery of Bad Debts		
Bad Debts - change in method		427,438
Cellular phone expense		498,395
Rate case expense error		1,811
QUEST amortization period		2,307,852
Pension expense		752,983
PBOP expense		2,399,548
Depreciation Expense - 1996 System		
Amortization Expense - 1996 Performance		
Property tax expense		881,691
Return and Income Taxes on 11.25% ROE		1,020,338
Total Revenue Impact		**15,461,460**

A. System Renewal Investments

Through November 30, 1996, the Company has made post test year system renewal investments of $27.6 million. By year end 1996, these investments will exceed $29.0 million. Exh. BGC-266. These investments are non-discretionary and reflect the Company's obligation to maintain safe and reliable service. Because the Department has decided to exclude these investments from rate base (Order, pp. 15-16) and to defer the implementation of PBR until November 1, 1997, the next opportunity for the Company to earn on and begin recovery of these investments will arise in late 2002.

In 2002, these system renewal investments will have been both used and useful for six years. Yet, the Department's Order does not allow the Company to earn a return on or recover these investments through depreciation charges. As Ms. Kelly demonstrates, that translates into a revenue loss in excess of $10 million. Exh. BGC-267.

New evidence confirms that the Company's forecast of its 1996 system renewal investments was accurate. The Company respectfully asks the Department to reconsider the changes in the regulatory landscape required by the shift to PBR, and include those investments in both rate base and depreciation expense. The exclusion of the system renewal investments is further exacerbated by the deferral of the PBR implementation until November 1, 1997, as the Company will also be denied an opportunity to earn on and recover its 1997 system renewal investments.

B. Investments in Information Technology

In 1996, the Company invested $1,582,000 in information technology, and requested the amount to be included in rate base Exh. BGC-268. As with the system renewal investments, the Department's decision to exclude them, and to defer implementation of PBR until November 1, 1997, means that the Company will not have an opportunity to earn a return on or recover these investments until late 2002. During the intervening six years it will incur a revenue loss totaling in excess of $2.0 million. (Exh. BGC-269). As Ms. Kelly testifies, the Company's investments in information technology are already in service. We ask that the Department reconsider its Order, and include these investments both in rate base and amortization expense for purposes of determining the Company's "cast-off" rates. Their exclusion is confiscatory.

C. The 1997 Union Wage Increases

Massachusetts law teaches that "a party to a proceeding before a regulatory agency such as the Department has a right to expect and obtain reasoned consistency in the agency's decisions." Boston Gas Company v. Department of Public Utilities, 367 Mass. 92, 104 (1975).

Department precedent is clear that a utility's cost of service should include a prospective union wage increase if it is reasonable and if it is scheduled to occur prior to the mid-point of the rate year. E.g., Commonwealth Gas Co., D.P.U. 87-122, pp. 54-55 (1982); Western Massachusetts Electric Co., v. Department of Public Utilities, 86-280-A, p. 74 (1987). Without explanation, the Department's Order cuts the Company's 1997 union wage increase in half, by multiplying the total amount of the increase by 6/12. Order, p. 49, n. 26. Changes in Department procedure must be made prospectively. New England Telephone v. Department of Public Utilities, 371 Mass. 67, 81 (1976). For the reasons set forth in Ms. Kelly's testimony, the Department must allow the Company to recover the full amount of the "known and measurable" union wage increase, just as it has for other utilities and just as it has in the Company's past several rate cases. D.P.U. 93-60 (1993); D.P.U. 88-67 (1988).

D. The 1997 Salary Increase for Non-Union Employees

The Company’s proposed “cast-off” rates did not include a 1997 increase for non-union personnel because the Company proposed moving to PBR effective December 1, 1996. The December 1, 1996 effective date of PBR would have captured the 1997 salary increase for non-union personnel. However, by delaying the implementation date of PBR until November 1, 1997 and citing the lack of a commitment for the non-union salary increase beyond 1996, the Department found no adjustment to be necessary. Order, p. 49. As the Department has ordered the Company to implement PBR effective November 1, 1997, the Company requests the Department to reconsider its request for the 1997 non-union salary increase.

Ms. Kelly has submitted a memo from the Company's President, committing the Company to a 1997 compensation pool in the amount of $1.2 million for non-union employees. Since (Exh. BGC-271) the commitment is express, and since the Department has already been satisfied that the increase is reasonable and in parity with union wage increases (Order, pp. 42, 48), the non-union wage increase should be granted. Fitchburg Gas and Electric Company, D.P.U. 1270/1414, p. 14 (1983).

E. FICA

The Department allows anticipated expense increases which are known, measurable and reasonably incurred. FICA is one of those expenses. Commonwealth Gas Co., D.P.U. 87-122, p. 65 (1982). The Department inadvertently omitted FICA taxes on the 1997 union wage increase that it approved. Ms. Kelly’s testimony also includes the corresponding FICA taxes on the 1/2 year union increase not granted and the 1997 non-union increase.

F. Overtime

Pursuant to Western Massachusetts Electric Company, D.P.U. 84-25 (1984), a

Company may adjust its overtime expenses if it can show "distortion in the test year figures." Id. at 145. The Department denied the Company's request for an overtime adjustment, ruling that the Company had not demonstrated that its test year overtime figures are non-representative. Order, p.45. Ms. Kelly, in her testimony, has included new evidence incorporating the Company's actual 1996 overtime experience which supports the Company's claim that the test year figures were distorted by unusually warm weather during the 1994/1995 heating season. As the Company's QUEST program was operational for the entire year of 1996, the new evidence reflects the downward impact of the QUEST program on overtime, but also confirms the Company's claim that 1995 overtime was considerably below normal. Since the Company has now demonstrated that test year overtime hours are non-representative, Department precedent requires reconsideration of the adjustment to ensure that the Company's rates are compensatory and reflective of its operating costs.

G. QUEST Employee Savings

The Department adjusted the Company's FICA tax expense, state unemployment tax expense, and federal unemployment tax expense as part of its finding not to allow 12 positions in the Company's employee level. Order, p. 61. However, in making these adjustments, the Department inadvertently failed to take into account the fact that only 85.4 percent of the cost is charged to expense. As Ms. Kelly testifies, when the 85.4 O&M percent is applied, the Department's adjustment is overstated by $8,952.

H. Bad Debts

As Ms. Kelly testifies, the Department made an error in its November 29, 1996 Order by failing to include in the "operating revenues" component of the bad debt computation the $8,017,131 in bad debts that were transferred to the CGAC, and the $1,174,030 in Production and Storage Expenses that were also transferred to the CGAC. Order, pp. 72-73. Since all CGAC revenues are a component of the bad debt calculation, the omission of the preceding amounts had the effect of understating the bad debt adjustment by $197,610.

In addition, the Department's Order is inconsistent with its decision in the Company's last rate case that appropriately "lagged" the Company's revenues by 12 months to match them with the related bad debt expenses. Ms. Kelly, in her testimony, presents evidence provided to the Department in D.P.U. 93-60 that confirms the existence of the lag. Exh. BGC-274. Moreover, from a legal point of view, since the lagged methodology was allowed in its last rate case, the Company is entitled to "consistent treatment" in this case, and at a minimum is entitled to prior notice of any change in methodology. Boston Gas Co. v. Department of Public Utilities, 367 Mass. 92, 104 (1975) (consistent treatment); New England Telephone Co. v. Department of Public Utilities, 371 Mass. 67, 81 (1976) (prior notice). The Department should revise its decision, and make the appropriate adjustment to bad debts by using the lagged method from D.P.U. 93-60.

I. Cellular Telephone Expenses

In its Order, the Department acknowledged that the Company's use of cellular phones had increased substantially and that the increase in cellular phone use due to QUEST recommendations reflected a permanent operational change for the Company. Order, p. 76. Nevertheless, questioning only whether the proposed adjustment reflected actual phone use, the Department relied on Milford Water Company, D.P.U. 92-101 (1992) to disallow the cellular telephone adjustment in its entirety. That case holds that a utility must demonstrate that an adjustment is both "known and measurable" if it is to be used to establish rates.

Ms. Kelly has provided new evidence that confirms that the Company's cellular telephone use has increased, that the expense adjustment made by the Company in its initial submission was accurate, and that the adjustment proposed by the Company was "known and measurable." Exh. BGC-275. Since the Company's cellular telephone expenses have increased substantially, and the new evidence satisfies the Milford Water Company test, the Company must be allowed to include these expenses in cost of service.

J. Rate Case Expenses

In the Order, the Department held that "the appropriate adjustment to test year . . . [rate case/PBR litigation] . . . expense is an increase of $102,254." Order, p. 79. On Schedule 2 of the Order, however, the adjustment for Unbundling Proceeding Expense is listed as $100,443. The figure contained in the body of the Order is correct, and the Schedule should be adjusted accordingly.

K. QUEST Costs

The Department ordered that the $7.7 million cost of the QUEST project be amortized over the five year life of the PBR plan. Order, p. 55. While the Company does not quarrel with the Department's finding that "the benefits of the QUEST program will last well beyond the Company's proposed two year amortization" (id.), it does ask that the Department reconsider the five year period. In its initial filing, the Company requested a two year period, citing the Department's recent decision to use that same period for amortizing the $332 million cost of NYNEX's Process Reengineering Plan. The Company bases its request for reconsideration on: (i) Ms. Kelly's unchallenged testimony that it will be necessary for the Company to undertake future reengineering efforts (Exh. DPU-118), and (ii) the unarguable legal principle that the Company is entitled to expect "reasoned consistency" in the decisions of the Department. Boston Gas Co. v. Department of Public Utilities, 367 Mass. 92, 104 (1975). The Company believes the Department committed legal error in refusing to use the two year period approved in NYNEX.

L. Pension Expenses

In deciding the Company's pension expense, the Department relied on a five year average of the Company's cash contributions. Order, p. 81. The period it chose -

- 1992-96 -- included four years of actual contributions and projected contributions for 1996. This is a selective use of precedent, and contrasts sharply with the Department's refusal to utilize projected information for other adjustments, including 1996 cellular telephone expense and 1996 system renewal investments, on the grounds that such data was not known and measurable. The Department is also aware that the Company's projected contributions for 1996 are subject to revision and can be made before September 15, 1997. For example, in 1995, the Company's actuary projected contributions of $2,684,388. Subsequently, in 1996, the Company's actuary determined that the 1995 contribution level was $7,981,179. Accordingly, if the Department is to adhere to its "known and measurable" standard, 1996 pension contributions are truly not. In computing the Company's allowable pension expense, the Department should employ the same method used (and allowed by the Department) to compute the Company's public liability expense. There the Department, consistent with Milford Water Company, relied on known and measurable payments made between 1991 and 1995. In addition, as the Department based its pension expense on the level of cash contributions, it should not have netted this amount against the average annuity gains. These gains only have the impact of reducing pension expense as shown on Exhibit AG-99 and DPU-200.

M. PBOPs

The Company believes the Department made a legal error in rejecting the third and fourth steps of the four step phase-in of PBOP expense specifically authorized in D.P.U. 93-60, p. 212. Order, p. 86. The Company is entitled to rely on that prior authorization, and the doctrine of "consistent treatment" means those two steps of the phase-in cannot be disallowed in this case without prior notice. Boston Consol. Gas

Co. v. Department of Public Utilities, 321 Mass. 259, 265 (1947) (Parties to a final order of the Department "may shape their conduct in accordance with it, secure in the reliance that it may not be changed to their disadvantage even under the guise of interpretation...."). The Company also notes that the treatment in D.P.U. 93-60 is consistent with the ratemaking treatment for PBOPs allowed all other utilities in the Commonwealth.

N. Property Taxes

The Department dismissed the Company's conclusion that property tax assessments are based on net book value as "speculative." Order, p. 110. Ms. Kelly's new evidence reflecting the Company's most recent property tax bills confirms the Company's conclusion that assessed valuations track net book values that the Company is required to report annually to the cities and towns it serves. While the Company's net book values increased nearly 40 percent between tax years 1992 and 1996, its assessments as a percentage of net book value averaged 99.85 percent over that same period. The largest variation was in 1992, when assessments were 100.90 percent of net book value. Exh. BGC-277.

O. Return on Equity

Both federal and state law set forth the factors which must be considered by the Department when it determines the Company's rate of return. E.g., Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591 (1942); Boston Edison Co. v. Department of Public Utilities, 375 Mass. 1 (1978).

Based on the Department's November 29, 1996 Order, Merrill Lynch finds that an 11 percent return on equity does not appear competitive relative to other investment opportunities and will likely cause Eastern Enterprises to look elsewhere for investment opportunities with more competitive return potential. Exh. BGC-280. Standard & Poor's, after reviewing the Department's Order, evaluated it to be negative and stated that it may adversely impact the Company's credit quality. Exh. BGC-279. In addition, Standard & Poor's confirms Mr. Moul's testimony (Exh. BGC-278) that performance-based rate plans, by their very nature, are considered to be more risky than traditional cost of service ratemaking. The Company's return on equity should be reconsidered by the Department, and at a minimum, should be set at 11.25 percent the return on equity approved in D.P.U. 93-60 and agreed to in the Settlement of November 15, 1996.

V. Performance-Based Regulation

A. Introduction

As described above, the modifications ordered to the Company's proposed productivity offset, or X factor, in the PBR plan result in a plan that in conjunction with the cast-off rates and service quality indices ordered by the Department will result in financial distress to Boston Gas and confiscatory rates over the six year life of the plan. The Department rejected the 0.1 percent X factor proposed by the Company and ordered that a 2 percent X factor be incorporated into the Company's price cap formula. The productivity offset, as ordered by the Department, is comprised of the following components: total factor productivity ("TFP"), input price differential, consumer dividend, and accumulated inefficiencies. As discussed below, the Company presents new facts and points out where the Department has inadvertently "double counted" benefits of its QUEST reengineering efforts and the increased throughput resulting from the Company's unbundling initiatives. The Company petitions the Department to reconsider its decision pertaining to the consumer dividend component and accumulated inefficiencies component of the productivity offset.

B. Accumulated Inefficiencies

In NYNEX, the Department reasoned that to accept that PBR is superior to cost of service regulation, one must accept that accumulated inefficiencies exist in a company's present operations. Order, pp. 281-282 (citing NYNEX, pp. 166-167). The Department relied on its NYNEX decision as grounds for including accumulated inefficiencies in the Company's productivity factor. The Department stated that it seeks to capture "efficiency improvements that should result as regulated companies move from cost of service regulation to PBR" through the accumulated inefficiencies factor. Order, p. 282. The Department ordered the same 1 percent accumulated inefficiency factor for Boston Gas as it had ordered for NYNEX.

1. The Incorporation of Accumulated Inefficiencies is Contrary to Worldwide Precedent.

To put the Department's decision to include an accumulated inefficiencies component in the Company's X factor in perspective, Dr. Lowry has performed a survey of other price cap plans. Exh. BGC-252, p. 4. His survey revealed that of the 36 price cap plans, worldwide, for electric, gas, telecommunications, and oil pipeline utilities, only one plan has an accumulated inefficiencies component as a factor defined separately from the consumer dividend. That plan is for NYNEX in Massachusetts. Dr. Lowry explains this result: "I believe that the accumulated inefficiencies of utilities are part of the grounds for expecting accelerated TFP growth under price cap regulation. Accordingly, they are already reflected in the X factors." Exh. BGC-252, p. 4.

2. The Incorporation of Accumulated Inefficiencies is Contrary to the Department's Long-Standing Mandate to Ensure that Rates are Just and Reasonable.

The Department's policy with respect to accumulated inefficiencies is contrary to its historic mandate to review utility rate filings and only allow those costs that are just and reasonable in a utility's rates. The accumulated inefficiencies factor is unwarranted because the Department found the Company's rates to be just and reasonable just three years ago. Boston Gas Company, D.P.U. 93-60 (1993).[5] In that proceeding, the Company's costs were vigorously contested and rigorously reviewed by the Department. Only prudently incurred costs may be recovered in rates. Id. at 24 ("For costs to be included in rate base, the expenditures must be prudently incurred . . ."). Following that proceeding, the Company undertook QUEST, thereby sustaining the efficiency of its operations.

In its initial filing, the Company presented a cost performance study performed by Dr. Lowry. Comparing the annual non-gas costs of 51 utilities across the nation, for the period 1984 through 1994, this study showed Boston Gas to be an average cost performer. Exh. BGC-12. After the Order was issued, Dr. Lowry updated that study to add the 1995 test year costs using the same elasticity estimates presented in the direct case. The updated cost performance study shows that in the test period Boston Gas had a statistically

---

[5] The Company's rate proceedings do not generally escape attention.

significant adjusted cost[6] that is 4.57 percent below the predicted cost of the average industry performer. Based on the 1995 results, Dr. Lowry concludes that with the QUEST performance improvements in full force, Boston Gas logged a superior cost performance in 1996. Exh. BGC-252, p. 3 and table 2.

Under the facts presented here, the inclusion of an accumulated inefficiencies factor as an add-on to the productivity offset is retroactive ratemaking in its quintessential form.

In light of the foregoing, the Company asks the Department to reconsider and eliminate the accumulated inefficiencies factor from the Company's productivity offset.

3. <u>A Review of the Explicit and Implicit Consumer Dividends Contained in Existing Price Cap Plans Demonstrates the Reasonableness of the Company's Proposed Consumer Dividend.</u>

The Department stated that the consumer dividend component of the X factor reflects expected future gains in productivity resulting from the move from cost of service regulation to PBR. Order, p. 280 (citing <u>NYNEX</u>, pp. 165-166). These gains include the rate of technological change affecting productivity and changes in demand for the service provided by the regulated firm. The Department gave the Company the same 1 percent consumer dividend it had determined appropriate for NYNEX, despite the Department's express recognition that the pace of technological innovation and competition that will improve the delivery and demand for telecommunication services are not present in the LDC industry. Order, pp. 55-56, 280. However, the Department noted that the slower rate of technological change is balanced by yet-to-be captured

---

[6] Adjusted for costs associated with QUEST program amortization, per Order. Exh. BGC-252, p.4.

QUEST productivity gains[7] and an expected increase in gas delivery throughput as a result of the Company's unbundling initiatives. Order, p. 281. On this basis, the Department added 0.5 percent to the Company's proposed 0.5 percent consumer dividend to arrive at a 1 percent consumer dividend.

In light of the Department's decision, Dr. Lowry examined the 36 active price cap plans and found that only a few have explicit consumer dividend components. Exh. BGC-252. His research shows that the average explicitly stated consumer dividend factor for the telecommunications industry is 0.64 percent. Exh. BGC-252, p. 6.

Dr. Lowry notes that some plans may contain a consumer dividend factor implicit in the X factor. His testimony steps through the calculation of the implicit consumer dividend in the active telecommunications price cap plans and shows this factor to be 0.65 percent, comparable to the 0.5 percent figure proposed by the Company. Further, as the Department has expressly recognized and Dr. Lowry has confirmed, it is important to note that telecommunications is an industry whose TFP trend (<u>i.e.</u>, historic productivity trend) is six times greater than the proxy TFP used by the Department for northeast LDCs. Exh. BGC-252. Based on the results of this study, which incorporates the high level of technological change facing the telecommunications industry, the Company petitions the Department to reconsider its decision to reject the 0.5 percent consumer dividend proposed by the Company and find that it is reasonable.

C. <u>The Department Has Double Counted the Benefits of the</u>

[7] As Ms. Kelly testified, future incremental QUEST savings are contingent on the Company making substantial incremental investments. Exh. BGC-38, p. 27. Those savings will not be realized if the Company is unable to make the requisite investments.

Company's Reengineering Effort and the Increased Throughput of the Company's Unbundling Program.

1. QUEST

The Company's proposed cast-off rates captured the benefits of its QUEST reengineering program by reducing test year cost of service. This fact is clear. What is not so clear is that the reengineering efforts of Boston Gas and other gas distribution companies are also reflected in the TFP component of the X factor. Also, the 0.5 percent consumer dividend proposed by Boston Gas was designed to show with customer future efficiencies anticipated to be achieved under PBR.

TFP reflects the historic productivity of an industry. As discussed in Ms. Bachelder's testimony, during the 1984 through 1994 historic period for which the TPF was calculated, the majority of northeast gas distributors in the study group implemented reengineering efforts. Exh. BGC-248, p. 8. Consequently, the Department's TPF proxy[8] reflects the rate of change in productivity for northeast gas distributors accomplished through reengineering programs.[9]

The Department should reconsider its decision to specifically include anticipated QUEST savings in the consumer dividend. The Department stated that additional, future QUEST savings should be returned to consumers via the consumer dividend. Order, p. 281. The 0.4 percent TPF proxy already reflects productivity gains resulting from reengineering projects. The 0.5 percent

[8] The Department's TFP proxy (calculated for the gas distribution industry nationwide) builds on the Company's proposed regional TFP to account for the fact that the regional TFP does not reflect throughput volumes. The Department addressed the absence of throughput volumes by adding 0.5 percent (e.g., adopting the 0.4 percent national TFP) to the Company's proposed TFP of -0.1 percent.

[9] In fact, initial programs typically capture the "low hanging fruit" or the most easily attained gains. Subsequent efforts produce efficiencies at a higher cost or slower rate.

consumer dividend proposed by the Company shares with customers additional efficiencies expected to result from PBR -- including additional anticipated QUEST savings. The Department has inadvertently double counted QUEST savings by stretching the consumer dividend by 0.5 percent, and should reconsider its decision and find that the 0.5 percent consumer dividend is appropriate.

2. Unbundling

The Department's finding that the Company's proposed 0.5 percent consumer dividend should be increased by 0.5 percent, in part to reflect expected increase in gas delivery throughput resulting from unbundling, should be reconsidered to eliminate the inadvertent double counting of increased transportation-related throughput, which is reflected in the TFP proxy ordered by the Department.

In determining the TFP component of the X factor, the Department recognized the appropriateness of using a northeast regional TFP for Boston Gas. Nonetheless, the Department rejected the regional TFP calculated by Dr. Lowry on the grounds that it only reflected growth in the number of customers and not growth in throughput volumes. Order, p. 276. To address the absence of throughput volumes in Dr. Lowry's regional TFP analysis, the Department adopted the productivity growth for nationwide LDCs as a reasonable proxy for LDC productivity growth. Order, p. 279. The Department increased the Company's proposed TFP a full 0.5 percent (from -0.1 percent to 0.4 percent) to account for increased throughput volumes. The consumer dividend should not recount the results of unbundling which the Department has already built into the

TFP.

VI. Service Quality Index

The Company requests that the Department reconsider its Order on the appropriate service quality index ("SQI") for the Company's PBR plan. Specifically, the Company requests the Department to reconsider the target performance level established for the telephone service factor ("TSF") measure; to reconsider the manner in which the Department will measure the Company's performance related to Consumer Division customer complaint statistics; and to reconsider the aggregate amount of the penalty as well as the amount associated with each of the seven measures. The Company also requests that the performance measurement period not commence until July 1, 1997 for application in year two of the PBR plan.

The Company presents with this motion the Reconsideration Testimony of Robert M. Miller. Exh. BGC-253. Mr. Miller's testimony contains updated information not available to the Department at the time of its Order that would have had a significant impact on the Department's decisions. A review of this evidence will demonstrate that certain of the Department's mandated performance benchmarks are based on incomplete statistical evidence of the Company's performance on service quality, and are inappropriate.

In its Order, the Department found that "the record does not support the Attorney General's assertion that the Company fails to provide good customer service." Order, p. 93. The Department also found that the purpose of a SQI in a well designed PBR plan is to protect against a reduction in service quality for monopoly customers and "should include measurable performance indicators and targets to evaluate a program's effects on safety, reliability and service quality." Order, p. 304 (citing Incentive Regulation, D.P.U. 94-158, pp, 63-64; NYNEX D.P.U. 94-50, p. 235). Despite these findings, the Department has created a SQI that goes far beyond protecting against a reduction in the Company's customer service. The Department's SQI requires the Company to reach unprecedented benchmarks or be subject to overly harsh penalties, and includes performance indicators that do not accurately measure the effects of the PBR plan on service quality. In establishing its benchmarks, the Department failed to consider the incremental cost to the Company, in the form of additional employees and investment in new technology, which would be required to achieve the performance goals it mandated. These incremental costs are not recoverable over the term of the PBR plan. In some cases, that cost is so great as to create perverse incentives with regard to the quality of the Company's service.

Finally, the imposition of a potential $700,000 penalty for each individual service quality measure appears to have been arbitrarily chosen. As Ms. Bachelder's testimony demonstrates, a potential aggregate $4.9 million penalty is 2.0 percent of the Company's distribution service revenues Exh. BGC-248, p. 10. This penalty level is double the penalty level the Department ordered for NYNEX. See, D.P.U. 95-38-A, p. 19. A proportional maximum penalty would be $2.5 million. Id. The Company requests the Department to reconsider this inadvertent result and order a service quality penalty that is proportional to that found in NYNEX.

A. The Measurement Period

The Company requests that the Department clarify that the measurement period used to determine whether the Company has met its service quality benchmarks will commence on July 1, 1997 for effect in year two of the Company's PBR plan. In New England Telephone and Telegraph v the Department of Public Utilities, 371 Mass. 67, 84 (1976), the court held that "when a major change in the regulatory standard is in prospect, there should ordinarily be warning to enable the Company to adjust both its practices and proof to the new situation." The Department's modifications to the Company's proposal, which includes both additional measures and removal of the weighting mechanism proposed by the Company, requires that the Company be allowed an opportunity to modify its behavior in an effort to achieve the new benchmarks. Thus, the Company proposes that the SQI measurement period commence on July 1, 1997 for effect in year two of the plan. Should the Department deem it necessary to apply an SQI to year one of the plan, the measurement period could commence no earlier than January 1, 1997 if the Company is to be allowed an opportunity to adjust its business operations. This would result in a six month measurement period for year one which may not accurately reflect annual performance.

B. Telephone Service Factor

The Company proposed an annual TSF benchmark that would require it to respond to 90 percent of all emergency calls and 80 percent of all billing and service calls within 40 seconds from the time the customer selects an option in the Teloquent phone answering system. Company Br. p. 61, App. A. The Company installed its Teloquent system in January 1996, and thus a full year of statistical data documenting the Company's experience under this system is not available.[10] Tr. 21, pp. 221-222. Information provided by the Company for the period March 1, 1996, through June 30, 1996, shows that the Company answered 93 percent of its emergency calls and 77 percent of its billing and service call within 30 seconds. Based on that four months of data, the Department found that the Company's proposed annual benchmark was too low and ordered the Company to achieve an annual benchmark of responding to 95 percent of emergency calls and 80 percent of billing and service calls within 30 seconds. Order, pp. 305-306.

The four months of data relied upon by the Department in establishing its annual benchmark is not representative of the normal annual call volume of the Company, does not account for unusual operating conditions, such as the recent flood, which caused widespread service loss and a corresponding spike in emergency calls, and does not represent a realistic performance goal for the Company.[11] The Company now has Teloquent information available for the period March 1, 1996, through November 30, 1996. Exh. BGC-255, BGC-256. A review of that data indicates that for the four month period July through October 1996, the Company has seen an increase of 23 percent in total emergency, service, and billing calls received (a 29 percent increase in emergency calls received, and a 22 percent increase in service and billing calls received), compared to the four month period March through June, 1996. As

---

[10] Prior to the installation of the Teloquent system, the Company was able to track total calls but could not categorize them by type.

[11] The four month period March through June does not include the peak calling periods of late August and early September when college students return to the area, the initial cold weather/no-heat calls that occur during the fall months, and the severe winter weather months that drive emergency calls.

unbundling progresses and customers attempt to deal with the changing industry, the Company expects its call volumes to increase even further.

From March through November, the Company has responded to 92.8 percent of emergency calls within 30 seconds and 95.3 percent within 40 seconds. Significantly, this nine month period does not include severe winter weather months. The Company is responding to 66.6 percent of billing and service calls within 30 seconds and 73.4 percent within 40 seconds.

The cost to the Company to achieve a 13.4 percent increase in service and billing calls responded to within 30 seconds and a 2.2 percent increase in emergency calls responded to within 30 seconds, as required by the Department, would be substantial and prohibitive. Further, the incremental cost to attain the benchmarks on a 30 second response time was not a matter of record for the Department. For the Company to meet these targets, it would need to hire a minimum of fifteen additional customer inquiry employees that would not be recoverable in base rates. Exh. BGC-257. This incremental cost outstrips the maximum penalty for failing to achieve the required performance. Thus, the only rational business decision for the Company would be to forego the cost to achieve the benchmark, seek to reduce costs in its telephone inquiry area, and accept the penalty as an annually occurring expense. Surely, this is not the Department's intended result.

Because this previously unavailable information would have had a significant impact upon the Department's decision, it is appropriate for the Department to reconsider its decision on the TSF benchmark for the Company. <u>Boston Gas Company</u>, D.P.U. 90-320-A (1992). The purpose of a well designed SQI is not to impose punitive measures on a company by creating unrealistic performance goals but, rather, to ensure against a reduction in service quality for monopoly customers. Order, p. 304. Accordingly, the TSF benchmark established by the Department should be reconsidered and adjusted back to the Company's proposal. The Company proposal provided a performance stretch for the Company which is achievable at minimal incremental cost.

Finally, the Company requests that the Department clarify its basis for determining if the Company has met the TSF goal. The Department has proposed a penalty of $140,000 for each percentage point the Company's service level falls below the TSF benchmark. Order, p. 310. The total possible penalty associated with the TSF measure is $700,000. However, the TSF benchmark is comprised of two separate and distinct measurements: one for emergency calls, and one for service and billing calls. The Order is unclear on the weight to be accorded each measure. Since it is the same resources that are utilized to respond to both types of calls, and the billing and service goal should never take precedence over the goal of responding to the safety of our customers, the penalty should be applied to the absolute value of the composite of the two indices.

C. <u>Customer Complaints</u>

In its Order, the Department made the following specific findings: (1) the Company has experienced a 15 percent decrease in consumer complaints to the Department, (2) the raw number of complaints does not necessarily reflect poor quality of service, (3) the Company has realized a 75 percent drop in billing adjustment in 1995 and a subsequent decrease in 1996, (4) the Company is operating in accordance with the Department's goal of encouraging all utilities to improve their quality of service and thereby reducing the number of abated bills and (5) that the record does not support the Attorney General's assertion that the Company fails to provide good customer service. Order, pp. 93-95. Despite these findings, the Department added two new measures to the Company's SQI proposal. Each relates to consumer complaint statistics maintained by the Department.

The first new measure requires "that the number of Department Consumer Division customer complaint cases for Boston Gas in a particular year shall be no more than 50 percent of the total number of customer complaint cases for all of the Massachusetts LDCs, including Boston Gas." Order, p. 308. The second new measure requires "that the number of Department consumer division customer bill adjustments for the Company in a particular year shall be no more than 65 percent of the total dollar amount of customer adjustments for all of the Massachusetts LDCs, including Boston Gas". Order, p. 308.[12] Each measure carries a penalty of $140,000 for each percentage point below the target level up to a maximum penalty of $700,000. Order, p. 310. Thus, the total penalty associated with Consumer Division complaint statistics could be as much as $1.4 million.

---

[12] The Order is ambiguous as to whether this benchmark is based on the number of adjustments or the dollar value of adjustments. Although, as noted infra, the Company believes that a measure based on number of adjustments is more appropriate than a measure based on dollar values of adjustments, the Company interprets the Order to refer to dollar value when read with the chart presented on p. 311. The Company requests the Department to clarify its intent. Further, there is no explanation for the 95% figure associated with these measures under the heading "benchmark/target value" in the chart on page 311. The Company requests that the Department clarify that these percentage numbers are clerical errors that should be ignored.

In its attempt to create a performance standard designed to ensure that the Company maintains its quality of service, the Department has mistakenly and inadvertently created a perverse incentive for the Company to act against the best interests of its ratepayers. For instance, Company records indicate that of the informal and adjudicatory hearings on Boston Gas matters handled by the Consumer Division since 1994, the Company has been found to have complied with applicable Department regulations in over 80 percent of the hearings.[13] Yet, had the performance measure been in effect for that period, each of those cases would have counted towards the $700,000 penalty.

Furthermore, because bill adjustments are a subset of total cases, the Department has created a performance measurement that will subject the Company to double counting of cases. Of the cases reviewed by the Department's Consumer Division through November 1996, customers were granted bill adjustments totaling $44,878. If this adjustment amount happens to be more than 65 percent of total adjustments for all LDCs then the Company could be exposed to an additional penalty of up to $700,000.

Thus, the Company's incentive is to avoid having any billing complaints referred to the Department. This could result in a "give away the store mentality," resulting in higher gas costs for firm sales customers, rather than risking exposure to a potential penalty of $1.4 million by challenging a customer's right to an inappropriate bill adjustment. Furthermore, the Company's aggressive collection activities which the Department agrees has the

---

[13] Exh. BGC-258. In addition, the Company randomly reviewed Department cases for 1996. That review indicates that the Consumer Division included, as cases, requests for billing information and calls from customers whose bills were correct but who were unable to make acceptable payment arrangements with the Company. These types of calls should not be included as cases for purposes of the benchmark.

result of driving up customer complaints (Order, p. 94) would need to be revisited. A less aggressive approach to collection would cause bad debt to rise, again, causing higher gas costs for firm sales customers. In the event that a billing complaint did reach the Department, the Company would then have the incentive to appeal every request by the Department for a bill adjustment to an informal hearing, and every adverse informal decision to an adjudicatory hearing. This would not be in the best interest of the customer, who would be denied the opportunity for an expeditious resolution of the complaint. Further, it would place an increased regulatory and administrative burden on the Department.

Finally, a performance measure based on a comparison of dollar value of adjustments is not indicative of overall performance. One extraordinarily large account adjustment could skew the results and subject the Company to a large penalty despite excellent overall performance. Similarly, an extraordinarily large adjustment for another LDC could allow the Company to achieve poor performance without penalty.

For all of the above reasons, a service quality performance measure based on Department complaint statistics is a poor indicator of service quality and provides the Company with the wrong incentives. Since this is surely not the result the Department intended, the Company requests that the Department reconsider its Order and establish a measure that is supported by the record and which would require the Company to maintain or reduce the level of second referrals and cases received by the Department over its previous three year rolling average. Exh. BGC-263. Such a measure would provide the proper incentives for the Company to maintain its good quality of service.

The Company also requests the following clarifications related to the manner in which Department complaint statistics are kept such that the Company can accurately measure its performance and determine its exposure to penalties. First, the Company requests that the Department clarify the precise definition of a case, and specify that this definition will be consistently applied to all LDCs. For instance, the Company is unclear whether cancel and re-bills resulting from estimated bills, which happens in the usual course of business, will be included as a case should a customer contact the Department before the adjustment is made. Nor is it clear that a case will be limited to alleged or actual billing errors, as opposed to complaints related to a customer's inability to make adequate payment arrangements to have service restored after termination for non-payment.

Second, the Company requests the Department to clarify that commercial accounts will not be included in the Department statistics for purposes of the benchmark. It is the Company's understanding that a Department ordered bill adjustment constitutes an affirmative finding that the LDC violated the billing and termination regulations of the Department. 220 CMR 25.00 et seq. 220 CMR 25.01(1) specifically excludes commercial and industrial accounts from the application of these regulations. Since the Company is potentially faced with a benchmark based on the dollar value of adjustments ordered by the Department (and commercial industrial accounts tend to be the larger dollar value accounts), it is particularly important that the Department exclude these accounts from the benchmark. In the past, the Department has on certain occasions included commercial accounts in its statistics for the Company.[14]

Third, the Company requests the Department to clarify that the “goodwill” adjustments it makes without a finding that the Company violated the Department’s billing and termination regulations will not be included in the benchmark. Exh. BGC-260.

Fourth, the Company requests the Department to clarify how and in what format information will be reported to the LDCs and what mechanism will be employed to allow the Company to dispute the Department’s records.[15]

VII. Customer Charges

Over the term of the PBR plan, the Company proposed to phase in cost-based customer charges. The proposal would reduce intra-class subsidies, which violate the Department’s goals of fairness and economic efficiency. Exh. BGC-3, p. 43; Exh. BGC-75, p. 10. Cognizant of bill impact and continuity concerns, the Company proposed to move toward full embedded customer charges in a gradual manner. Exh. BGC-75, p. 22.

In its Order, the Department ordered that no rate component, e.g., customer charges, increase by more than the rate of inflation. Order, p. 334. As a result, the Company’s move toward full embedded cost customer charges and the elimination of intra-class subsidies will be slowed down significantly and will

---

[14] See, Exh. BGC-261, BGC-262. The Company has no way of determining if the Department has included commercial/industrial accounts in its statistics for other LDCs.

[15] The Company is concerned that it did not receive third quarter 1996 information from the Department until December 3, 1996, and that the monthly statistics reported for the first and second quarters of 1996 do not reconcile with the Department’s quarterly statistics for the same periods.

not be achieved during the initial term of the price cap plan. At the time the Department made its decision, it did not have information regarding the class-by-class embedded customer cost component. The Company is providing this new evidence in Ms. Bachelder's testimony as Exhibit BGC-248. Additionally, Exhibits BGC-250 and 251 show the schedule of maximum customer charges pursuant to the Department's Order. For example, the exhibit illustrates that the maximum customer charge for Rate Class R-3 starts at $9.50 and only increases to $10.75 by the end of the price cap period, assuming an inflation rate of 2.27-2.59 percent. The customer charge at the end of the plan period will reach only 53 percent of the fully embedded charge of $20.45, a shortfall of $9.70 per month.

Based on this new evidence, the Company asks the Department to reconsider its decision to constrain customer charge increases to the inflation rate and allow the Company to increase customer charges at a rate that would bring all customer charges closer to the fully embedded level at the end of the PBR period.

VIII. Margin Sharing

Boston Gas seeks clarification on the Department's findings relative to margin sharing. Order, pp. 256-257. As filed, the Company proposed a broad-based incentive mechanism to address margin earned in the following market segments: non-core firm transportation, interruptible transportation, and vehicular natural gas sales. Under the proposal, the Company would retain all margin derived from its local distribution system market offerings: firm tariff transportation, non-core firm transportation, interruptible transportation, and vehicular natural gas sales, after compensating its firm customers -- via a one time buyout -- for the retention of margins previously shared between shareholders and firm customers. Boston Gas would return to firm customers all margin derived from its city gate market offerings: interruptible sales, sales for resale, and capacity release.

Currently, net economic benefits from non-core firm local transportation contracts filed pursuant to D.P.U. 92-259 are shared 50/50 between shareholders and firm customers. The Company shares margin derived from upstream sales of gas and capacity 75/25 between customer and shareholder, respectively.

In the Company's last rate case, Boston Gas Company, D.P.U. 93-60, the Company petitioned to extend the 50/50 benefit sharing approved in Boston Gas Company, D.P.U. 92-259, for non-core firm sales, to the following market segments: interruptible sales and transportation, capacity release, and off-system sales. The Department declined the Company's request, left the 50/50 benefit sharing arrangement for non-core firm sales intact, and ordered that margin from the three other market segments, above a specified threshold, be shared 75/25 between firm customers and shareholders, respectively. D.P.U. 93-60, pp. 298, 323-325. The Department noted that the record did not support a finding that "margins from the three market segments [i.e., interruptible sales and transportation, capacity release, and off-system sales] above a threshold proposed to be split represent incremental benefits. Therefore, the reasoning which supported a 50/50 benefit sharing in D.P.U. 92-259 is not entirely applicable." D.P.U. 93-60, p. 324.

Subsequent to the issuance of D.P.U. 93-60, the Company petitioned to extend and modify the authority granted in D.P.U. 92-259. It was in this petition that the Company drew the distinction between the appropriate ratemaking treatment for margin derived from non-core firm transportation and burner tip sales, and non-core firm city gate sales. The Company asked that it be allowed to make non-core firm city gate sales pursuant to D.P.U. 92-259, and proposed that margin from these sales be split 75/25 (customer/shareholder) to reflect the different way that gas and non-gas costs are collected from core customers. The Company did not propose to change the 50/50 sharing of benefits for non-core firm transportation contracts. Petition to Renew Non-Core Contract Process in D.P.U. 92-259, pp. 8-9 (April 3, 1995). By letter dated May 12, 1995, the Department approved the Company's petition.

In its Order (D.P.U. 96-50), the Department is silent on the Company's proposal to retain all margins from non-core firm transportation contracts made pursuant to D.P.U. 92-259. The Department only directed the Company to "maintain its existing margin sharing arrangements for interruptible service, off-system sales, and capacity release." Order, p. 257.[16] By its silence, the Company understands that the Department approved its request to retain all margin from non-core firm transportation contracts, entered under the authority of D.P.U. 92-259.

[16] In the Order, the Department mis-cites its precedent relative to the 50/50 share for non-core firm transportation and states that "In the Company's last rate case, the Department approved a 75/25 sharing above a set threshold of margins resulting from non-core firm sales, interruptible sales and transportation, capacity release, and off-system sales." Order, p. 256 (emphasis added, citations omitted). D.P.U. 93-60 did not include non-core firm sales in the 75/25 margin sharing incentive.

IX. **Capacity Allocation and Transportation Terms and Conditions**

The Company requests that the Department reconsider and clarify certain aspects of its order concerning capacity allocation and the terms and conditions of transportation service. In particular the Company requests reconsideration and clarification of: (1) the Department's order on downstream assets; (2) the Department's Order concerning financial security requirements for suppliers; (3) the Department's Order concerning disbursement of penalty revenues; (4) the Department's Order regarding the extension of upstream capacity contracts, (5) the price to be charged for interim sales service; and (6) the Department's Order on Force Majuere.

The Company presents with this motion the Reconsideration Testimony of William T. Yardley which contains information concerning the Company's downstream assets which was not presented to the Department in Phase I and which would have substantially affected the Department's order had it been considered.

A. Downstream Assets

In its Order at p. 233, the Department found that "the Company must provide transportation customers with reliable access to its downstream assets" and noted that "the availability of downstream assets would facilitate the development of an alternative general transportation program and would allow customers to self balance." The Department directed the Company to "make available to converting firm sales customers, on a voluntary basis, each customer's respective pro rata share of downstream assets at cost based rates consistent with the Company's method for allocating pro rata shares of upstream capacity." The Department further directed that "to the extent that a converting sales customer does not wish to utilize 100 percent of the Company's downstream capacity, [the Company should] make the remaining resources available, and allocate any margins generated from downstream assets in a manner consistent with that prescribed in D.P.U. 93-141-A."

The Department's directive is unclear on how the Company is to "make available" its downstream assets to converting customers. Based on the record evidence, It seems that the Department is directing the Company to modify the balancing service offered as part of its general transportation service so that customers may subscribe on a voluntary basis. This would allow converting customers the opportunity to opt out of the Company's balancing service in favor of competitive alternatives. Once the Company implements a self-balancing option based on a sendout formula determination of a customer's daily delivery requirements, the access to downstream assets ordered by the Department will be provided.[17]

Apart from the balancing service, the Company did not contemplate a pro rata allocation of downstream assets as part of Phase I. In the unlikely event that the Department intended to require an actual pro-rata allocation of its downstream assets to converting sales customers, then the Company has due process as well as operational concerns.

The first notice that the Department intended to decide the disposition of

---

[17] The Department directed the Company to develop a self-balancing option on a pilot basis within six months of the Order.

downstream capacity in Phase I was in the Department's Order. The Company reasonably understood that disposition of downstream assets was a Phase II issue, and, thus, the record on this issue is barely developed.[18]

At the pre-hearing conference of June 20, 1996, the hearing officer in this case stated that the Department would consider "the Company's capacity assignment program" in Phase I. Tr. p. 15. The Company's capacity assignment proposal before the Department at that time did not include downstream assets. The Company's proposal with respect to downstream assets was to make them available through its balancing service. In response to various requests for clarifications made during the hearing, the Department initially indicated a willingness to issue a statement clarifying what was in Phase I and Phase II, respectively. However, the Department then declined to clarify the phasing of the proceeding, and the hearing officer stated, "I think it's clearer if we just indicate here that the testimony that Luthern and Yardley were going to give with respect to the exit strategy of the Company will be deferred to Phase II of the proceeding, and there will be no further comment on the phasing in written form." Had the Company filed testimony concerning the specifics of its exit strategy, it would surely have contained a discussion of the role of downstream assets in maintaining system reliability, operational integrity, and the Company's ability to meet whatever continuing role as a supplier, if any, may be imposed upon it in Phase II. In accordance with the Department's ruling at the procedural

[18] The Company notes that in articulating the positions of the parties on this issue in the Order, the Department does not include a position for the Company as the system operator, for the Company took no position on this issue in Phase I reasonably believing that the disposition of downstream assets would be considered in Phase II.

conference, this testimony was not presented.

On July 19, 1996, DOER presented an alternative capacity assignment proposal to the Company through the testimony of Mark C. Pocino. Mr. Pocino proposed a voluntary assignment scheme for both upstream and downstream capacity. The Company did not understand that Mr. Pocino's testimony changed the scope of Phase I contemplated by the Department at the pre-hearing conference.

On July 26, 1996, the Company filed a motion for clarification of what issues would be decided in Phase I. This was in response to certain discovery and cross examination directed at items the Company understood to have been reserved for Phase II. In its motion, the Company stated:

> "It was and remains the Company's understanding that the unbundling/exit issues to be considered in Phase I of this proceeding are limited to transportation tariffs for all commercial/industrial customers, and a capacity release program. Together with the other significant issues to be addressed in Phase I, including the Company's revenue requirements and performance based regulatory plan, these present an ambitious agenda for the parties and the Department to accomplish in the coming months.
>
> No other issue -- including residential unbundling, the ultimate disposition of the Company's local production and storage assets, and the Company's residual service obligation once it has withdrawn from the merchant function -- needs to be decided for commercial and industrial customers to have unbundled transportation on the Company's system and access to pipeline capacity as of December 1, 1996. The Company's proposed balancing service (Rate Schedule S-1), which corresponds to the General Transportation Receipt Service, effectively provides the market access to Boston Gas' local production and storage capacity at cost.

TMG responded to the motion and asked that the Department clarify that, contrary to the Company's understanding, access to local production and storage assets was part of Phase I. TMG Motion for Clarification, p. 2. Despite the obvious dispute over whether an allocation of downstream assets was part of Phase I or Phase II, the Department did not rule on these motions for clarification until September 9, 1996, after the close of hearings.[19] Even then, the ruling did not express that a specific disposition of downstream assets would be decided in Phase I. The Department merely stated that "the capacity assignment method" would be determined in Phase I.[20] As late as August 30, 1996, the last scheduled day for hearings, the Hearing Officer asked Company counsel whether leasing of downstream assets was a Phase I issue. Counsel deferred to the Department, noting that an order on the Company's Motion For Clarification was still pending. Tr. 23, p. 23. Procedural fairness and due process require that the issue of assigning pro rata shares of downstream assets be deferred to Phase II.

The Company's balancing service, as approved by the Department in its Order, effectively provides transportation customers with access to downstream assets at cost based rates. Because this service is priced on a volumetric basis, customers pay only for that portion of downstream assets that they use. Once a self-balancing option is in place, the Company's balancing service will be voluntary for all transportation customers. An order which requires the Company to go beyond providing this access and to make pro rata shares of its limited LNG and propane resources available to third parties to manage on their own would threaten system integrity and jeopardize reliability of service for all customers.

---

[19] On September 18, 1996, the Department held one additional day of hearing limited to the issue of post retirement benefits other than pensions.

[20] This same terminology was used by the Department at the pre-hearing conference, when the only capacity proposed to be assigned was upstream capacity.

The Department recognized the complexity of upstream storage unbundling and the potential negative impact on Tennessee Gas Pipeline's ability to rely on storage to support system activities and to maintain operational integrity if they are allocated to inexperienced marketers. The Department expressed its serious concern and recommended that Tennessee take this concern seriously as well, however, recognizing that the record was incomplete on that matter, it deferred ruling on Tennessee's recommendation that the Company remain in a contractual relationship with Tennessee at the city gate until the Department further explores the issue in Phase II. Order, pp. 223-224.

This operational concern is magnified exponentially when applied to unbundling of downstream storage assets and the negative effect on the Company's ability to maintain the operational integrity of its distribution system. Just as Tennessee relies on upstream storage to support a variety of system activities and to maintain operational integrity (Tennessee Br. p. 2), so, too, the Company relies on downstream storage assets to maintain deliverability on its system. Downstream assets are complex to manage, restrictive in terms of where and when they can be used, and critical to system integrity. The attached testimony of William T. Yardley, Manager, Gas Acquisition and System Control, details the manner in which the Company manages its downstream assets and explains the operating constraints that make it impractical if not impossible to achieve a pro rata allocation of downstream assets consistent with the Company's allocation of upstream assets. As noted by Mr. Yardley, to assign portions of downstream assets and maintain system reliability at the same time, the Company would have to impose severe limitations on third-party use of the downstream assets, such that these third parties would be required to utilize them at the same time and in the same manner as would the Company. Thus, suppliers would have no greater access than what is already provided through the balancing service.

Because the Company was not on notice that disposition of downstream assets would be determined in Phase I, the Department has not yet heard from the Company -- the system operator -- on this critical and complex operational issue. If, notwithstanding the due process question, the Department is now inclined to decide this issue in Phase I, the Department should reconsider its Order based on Mr. Yardley's testimony.

B. <u>Financial Security</u>

The Company requests that the Department reconsider and clarify its Order on financial security requirements. In its Order at pp. 376 and 377, the Department found that "credit checks currently required by pipelines would provide adequate assurance that a supplier will most likely be able to meet its financial obligations. Demanding additional financial security from suppliers who have met the pipeline criteria may act as a barrier to entry." The Order states that there may be occasions when a supplier may not have met a pipeline's creditworthiness criteria, in which case the Company would be allowed to evaluate the supplier's creditworthiness and require "some sort of financial security". Order, p. 377. In making this finding, the Department seems to have inadvertently overlooked the fact that a supplier who has not met the pipelines' creditworthiness criteria will not qualify as a supplier on the Company's system. To qualify on the Company's system under the terms and conditions of transportation service, a supplier must “be and remain an approved bidder on the upstream pipelines and underground storage facilities on which the Company will assign capacity...” Otherwise, a supplier could not accept the Company’s pro rata assignment of capacity for its customers. Thus, under the Department’s Order, there is no instance in which the Company could require a financial security instrument from a supplier, unless and until they are disqualified for failing to deliver and subsequently seek to be reinstated. This is too late to ensure that customers are adequately protected against the cost of a supplier’s default.

In addition, while the Company can determine whether a supplier is qualified on upstream pipelines by checking the electronic bulletin boards, it will not know whether or not a security instrument was required. Furthermore, even if a supplier posts security to the pipeline, that security cannot be accessed by the Company should the supplier default on its obligation to deliver to the Company’s city gate. In that case, the Company’s customers will be responsible for the cost of the Supplier’s default. The Company does not believe that this is the intended result of the Department’s Order.

Accordingly, the Company requests that the Department reconsider its Order on financial security for suppliers and allow the Company to require reasonable security to protect its customers from a supplier default. In the event that the Department reconsiders its Order in this regard, the Company requests that the Department clarify that the meaning of the phrase “some sort of financial security” (Order, p. 377) means the security proposed by the Company in its filing.

C. Disbursement of Penalty Revenues

In its Order at p. 381, the Department found that the Company did not provide adequate justification for its proposal to flow monthly penalty revenues back to firm sales customers through the CGAC, and directed the Company to credit all penalty revenues to low income customers. The Company proposed to credit low income customers with daily penalty revenues only. The Department found that flowing a portion of the penalty revenues to firm sales customers would send incorrect commodity price signals to these customers. Order, p. 381. The Company asks the Department to reconsider its finding because it directly conflicts with the Order in the Company's last rate proceeding where the Department found that monthly imbalance penalties are tied to gas supply costs and should be flowed back to firm sales customers. Boston Gas Company, D.P.U. 93-60 at pp. 482-483 (1993). The Company did not attempt to re-justify this finding, but it remains true and should be adhered to.

D. Extension of Capacity Contracts

In its Order at p. 223, the Department directed the Company to "extend all of its upstream pipeline and storage capacity contracts necessary to maintain reliability through the interim period." The Department stated that it will address in Phase II whether these contracts should be extended beyond the interim period.[21] The Company seeks the Department's clarification on this point because it may not be possible to comply with the Department's Order under the terms of certain of its contracts. While the Company can extend certain of its

---

[21] Although it is not explicitly defined in the Order, the Company assumes that "interim period" extends from the present until a final decision is rendered in Phase II. If this assumption is not correct, the Company requests the Department to clarify what constitutes the interim period.

Algonquin contracts that are in evergreen status from year to year (provided Algonquin does not exercise its option to terminate them and require the Company to extend them for a term certain), the Company has other contracts that require the Company to provide notice of its intent to terminate or renew for a term certain . At this time, there is no way for the Company to ascertain what the end date of the interim period will be. Without certainty as to the end date of the interim period, the Company is not certain for what term it should negotiate to extend contracts it deems necessary to maintain reliability. Moreover, for contracts that require renewals to be for a minimum term of years, the Company's obligation cannot be greater than to attempt to negotiate a renewal term that complies with the Department's directive. If the pipeline requires that the contract be honored, which is its right, the Company would be forced to renew for the minimum term required by the contract. Thus, the Company requests that the Department clarify that for any of its upstream capacity contracts, the Company deems necessary to maintain reliability and which expire or require notice of termination or renewal during the interim period, the Company should negotiate in good faith to extend such contracts through the year 2000, and, if it is unable to do so, should renew for the minimum term required by the contract.

E. Interim Sales Service

In its Order at p. 378, the Department directed the Company to charge its Cost of Gas Adjustment Clause ("CGAC") for interim sales service, unless the Company incurs additional costs that are attributable to the provision of interim sales service. In that case, the Company would charge its interim sales service customers the daily index price contained in the terms and conditions of transportation service. In making this Order, the Department apparently overlooked the fact that there may be instances where the Company incurs additional costs attributable to the provision of interim sales service on days where the index is lower than the CGAC. On those occasions, it would not be appropriate for the Company to charge the index price, as core customers would be subsidizing the service. Since it is unlikely that the Department intended this result, the Company requests the Department to clarify that in all instances, the Company shall charge the higher of the CGAC or the index for interim sales service.

F. Force Majuere

In its Order at p.385, the Department directed the Company to modify the Force Majuere provision of the terms and conditions of transportation service as follows: (1) breakage or accident to machinery or pipeline would not qualify as a Force Majuere event even if it was a result of the Company's negligence or misconduct; and (2) in the event the Company is unable to restore service to a customer in 30 days, the customer (a) is immediately relieved of any further demand charge obligation, and (b) may, at its sole option, elect not to terminate the contract by providing Boston Gas with an additional 30 days to correct the service interruption.

Under the Company's proposal, in the event of a Force Majuere, a customer's service would not terminate absent notice from the customer that it desired to terminate service, a right the customer has regardless of a Force Majuere event. This creates a default position of continuing service once it is restored. By requiring that customers make an affirmative election in any case, the Department has inadvertently introduced an ambiguity.

Furthermore, the Company requests that the Department clarify that it intended to relieve a customer of the obligation to pay demand charges only during the period the Company is unable to provide service. Under the Department language, in the event a customer remains silent, the Company is unclear on the legal posture of the service. A strict reading of the Department's language would allow a customer to continue to receive service after the Force Majuere event is resolved without obligation to pay demand charges. It is unlikely that the Department intended this result.

Thus, the Company requests that the Department reconsider section (2) of its Force Majuere language and proposes the following:

> If Company is unable to render the firm transportation service contemplated by these Terms and Conditions as a result of a Force Majuere, and such inability continues for a period of 30 days, Customer shall be relieved of any further demand charge obligation until such time as service is restored. Customer may provide written notice to Company of its desire to terminate service at the expiration of 30 days from Company's receipt of such notice (but no sooner than 60 days following the outset of the Force Majuere). If Company has not restored service to Customer at the end of such notice period, Customer's service will terminate and both parties will be released from further performance thereunder, except for obligations to pay sums due and owing as the date of termination.

X. <u>Conclusion</u>

As promulgated, the Department's Order will have adverse and far-reaching impacts on the industry, the Company, its customers, and the energy policy of the Commonwealth. We respectfully request that the Department reconsider its Order as requested herein, and revise and amend it in accordance with the foregoing petition.

Respectfully submitted,

BOSTON GAS COMPANY
By its Attorneys,

____

Catherine L. Nesser
Thomas P. O'Neill
Jeffrey M. Leupold
Boston Gas Company
One Beacon Street
Boston, Massachusetts 02108
(617) 742-8400

____

James K. Brown
Foley, Hoag & Eliot
One Post Office Square
Boston, Massachusetts 02109
(617) 832-1000

Dated: December 19, 1996

Boston Gas Company

D.P.U. 96-50
Petition for Reconsideration

Exhibit BGC-246

Reconsideration Testimony
of Chester R. Messer

Q. Please state your name, position and business address.

A. Chester R. Messer. I am the President of Boston Gas Company with principal offices at One Beacon Street, Boston, Massachusetts, 02108.

Q. Is there an exhibit accompanying your testimony?

A. Yes, Exhibit BGC-247.

Q. Was it prepared by you, or under your supervision and control?

A. Yes, it was.

Q. Is Exhibit BGC-247 true and correct to the best of your knowledge or belief?

A. Yes, it is.

Q. Please summarize the reasons underlying the Company's initial filing with the Department in May, 1996.

A. The Company's initial filing was specifically designed to further the

Department's established goal of reducing energy costs for Massachusetts consumers, and reflected the Department's belief that this can be best achieved by effective market-based competition. Boston Gas wholeheartedly concurs with the Department on both points. To prepare ourselves for the competitive marketplace, we reengineered the Company and carefully crafted our initial filing to include a move to Performance Based Regulation, a two-step unbundling plan, and a proposal to exit the merchant function.

Our initial filing also contained an increase in base rates that was designed to enable the Company to continue to maintain its financial position during the period of the PBR plan, a period of considerable uncertainty, without impairing our public service mandate to provide safe and reliable service. This increase was in accordance with the Department's stated objective of moving to competition while safeguarding system integrity and without jeopardizing the financial health of the utilities it regulates.

Q. Does the Company believe the Department's November 29, 1996 Order meets these goals?

A. No, we do not. The Department's Order creates serious financial problems for the Company, which will threaten our continued ability to operate and provide the high level of service our customers now receive. I strongly urge the Department to closely review our Petition for Reconsideration of its Order. We are particularly troubled by the policy implications of rejecting the November 15, 1996 Settlement Agreement, by the inadequacy of the "cast-off" rates established by the Order, and by the Department's amendments to the Company's PBR Plan, both in terms of the 2.0% X factor and the SQI provisions. As I will describe in greater detail, the new base rates are simply too low; when they are considered in conjunction with the Department's PBR Plan, they will result in confiscatory returns that will only deteriorate over the life of the Plan. This, in turn, will adversely affect our ability to expand our operation and will deny the benefits of competition in the natural gas industry to Massachusetts consumers. In the long run, energy costs will rise as the Company is forced to return to cost of service ratemaking.

At this point in the process, we have no choice but to take the following steps, in addition to our Petition for Reconsideration. Unless the Department modifies the Company's base rates and PBR Plan in a manner that allows the Company a fair opportunity to earn adequate returns, the Company will be forced to withdraw the PBR proposal. As much as we agree with the Department that cost of service ratemaking is inconsistent with a competitive environment, we must preserve our ability to seek rates that enable us to meet our public service obligation. Moreover, given the uncertainty of the timing of the reconsideration process (including possible court appeals), we are deferring our Phase II proposals until the issues surrounding our base rates and PBR proposal are satisfactorily resolved. Depending on the outcome of that process, the Company is rethinking all of its options, including its overall business strategy.

Q. What, precisely, is the Company seeking in its petition?

A. The key features of our request are as follows:

First, we are asking that the Department implement the substance of the November 15th Settlement that was rejected by the Department, including the agreed-upon $13.0 million increase in base rates; an $8.5 million expense recognition for PBOPs (post-retirement benefits other than pensions), which includes the phase-in of steps three and four allowed in D.P.U. 93-60; an 11.25% return on equity; the new, fixed IT rates; and retention by the Company of all IT margins. Ms. Kelly provides cost of service justification for the $13.0 million increase in her testimony that accompanies the petition.[22] Ms. Bachelder testifies to the fixed price IT option and IT ratemaking provisions of the Settlement, and points out that those rates were designed by the parties to accommodate the needs of commercial and industrial customers, and to meet the policy goals of the Department and of the Commonwealth. Ms. Bachelder notes that the parties to the Settlement took the $2-4 million revenue loss that the Company risks under those rates into account in agreeing to the IT margin retention provision and the $13.0 million increase in base rates.

Second, the Company asks that the Department modify its PBR decision by eliminating the 1.0% "accumulated inefficiencies" provision, as well as the 0.5% added to the Company's proposed "consumer dividend." As Dr. Lowry testifies, Boston Gas is a superior performer. As

[22] In fact, Ms. Kelly's analysis supports a substantially larger increase. Nevertheless, the Company seeks no more than the $13.0 million agreed to in the settlement.

I will describe, the Department's Order, as it currently stands, will ensure confiscatory earnings for the Company through 2002, even under the most optimistic assumptions as to growth in throughput and cost control. This is unacceptable.

Additionally, as Ms. Bachelder testifies, portions of the SQI require modification, particularly the $4.9 million aggregate penalty provision which is well in excess of the penalty provision in the NYNEX plan and more than 10% of the Company's pre-tax profits. Other features of the SQI that are problematical are described by Mr. Miller. They include the initial measuring period (which could result in imposing penalties on past conduct without prior notice) and the three new measures that received almost no attention in this case: abatements, TSF and complaint levels.

Third, there are several features of the Order related to service unbundling and the terms and conditions of transportation service that we would like reconsidered or clarified. These include assignment of downstream assets, treatment of penalty revenues, extension of capacity contracts, pricing of interim sales service and the conditions of Force Majuere. The details are set forth in the Company's petition, and in the testimony of Mr. Yardley.

Q. Please describe your concerns with the settlement process.

A. Prior to our filing this past spring, we met with the Department, the Administration, DOER, the Attorney General, key legislators, customers, marketers and other stakeholders. Our purpose was to inform stakeholders about the bold steps the Company was preparing to take to bring the benefits of competition to our customers via our plans to unbundle and exit the merchant function.

Based on the comments we received at those meetings, we agreed that it would be in the best interests of customers to gather additional information from other interested parties. We also agreed to defer the filing for one month, (despite the loss of $1.0 million in gross margin), not only to expand our understanding of the differing (and often competing) interests of the various stakeholders, but also to give them a more detailed understanding of the complex, interrelated nature of our filing. As a result of those discussions, we modified our plan by incorporating some of the improvements suggested by those other parties.

At the same time, consistent with the Department's suggestion that we employ a mediator, we contacted the Massachusetts Office of Dispute Resolution to assist in negotiating the plan. We willingly took the Department's suggestion, particularly since we were aware of the successful use of that process in the parallel Electric Industry Restructuring proceeding.

After months of intense negotiations, we resolved many of the key issues in this proceeding and they were incorporated into the November 15 Settlement Agreement. That resolution served the interests of all stakeholders: customers in general (represented by the Attorney General), the Administration (DOER), large commercial and industrial customers (AIM and TEC), low income customers (Low Income

Intervenors), and, finally, the Company. The resulting Settlement Agreement was accepted by all parties involved and represented a fair balancing of all interests arrived at after extensive arms length negotiation. Each of the issues resolved in the Settlement was interrelated, and the parties to the Settlement treated it as a package deal.

Despite the broad consensus reached, and the fact that the Settlement resulted in a return on investment that did not differ from what was allowed by the Department in the Company’s last rate proceeding and approximated other recently approved settlements, the Department summarily rejected the Settlement stating, without further explanation, that it "failed to serve the interests of the ratepayers." Beyond the fact that the Settlement was ratified by the stakeholders who represent the ratepayers, the Company believes the Department should reconsider a sound and workable agreement arrived at by an established, time-honored process that was encouraged by the Department. We formally request the Department reconsider its summary rejection of the Settlement and reinstate the substance of its provisions.

Q. Please elaborate on your conclusion that the Department's new rates and PBR Plan are confiscatory.

A. Using the new rates and the PBR Plan authorized by the Order, we have modeled the financial performance of the Company over the six year period 1997-2002, as shown in Exhibit BGC-247, pp. 1-6. Utilizing optimistic assumptions as to growth in throughput and conservative assumptions as to increases in costs, our opportunity to earn the 11% return on equity allowed by the Department is non-existent over the six year life of the plan: This is shown as follows:

Year	Return on Average Common Equity
1997	8.8%
1998	7.5%
1999	6.7%
2000	6.1%
2001	5.5%
2002	5.3%

The Company cannot survive with returns in this range. They are confiscatory. Indeed, our owner, Eastern Enterprises, is likely to look elsewhere for investment opportunities offering a more competitive return, and is unlikely to invest additional equity capital in the Company as long as our earnings and corresponding rates of return remain at these depressed levels. This would exacerbate the problem, for our analysis assumes that a total of $65 million of additional equity capital will be reinvested in the Company by Eastern over the period 1996-2002 and that the Company maintains a sufficiently high credit quality to attract an incremental $40 million in debt financing. Both these assumptions are critical to our ability to grow and maintain the safety of our distribution system.

Our analysis next looked at the incremental revenue requirement needed to earn the 11.0% rate of return allowed by the Department. As can be seen on the bottom line of page 1 of Exhibit BGC-247, the

Company will need to either cut costs or further increase sales margins beyond the levels already contained in this forecast by an incremental $3-9 million in each year of the Plan. Thus, in 1997, cost reductions and/or increased sales margins would have to total $9 million to yield an 11.0% return. In 1998, an additional $6 million would be necessary, for a total of $15 million; in 1999, the total is $19 million, etc.

Quite frankly, this is impossible. The sales goals we have built into our forecast are extremely optimistic, and involve a considerable "stretch". One of the critical problems we face is the fact that energy demand in the state is flat, and thus growth can only come by taking market share from other fuels. We believe this can be done, but it will require a significant increase in our marketing efforts. Thus, I have authorized and included in the analysis a $2.0 million expense increase in the Company's marketing budget to achieve our sales growth forecast of 2.3 Bcf per year over the period (our average for the past five years is less than 1.6 Bcf). To achieve significant sales growth above the 2.3 Bcf level would require a substantial capital investment in infrastructure, as well as significant additional marketing expenditures (e.g., human resources, advertising, promotional, etc.).

Our ability to cut costs is severely limited, and does not begin to approach an incremental $3-9 million per year. Excluding CGAC related items, our approved "distribution" cost of service, per the Department's Order, breaks down as follows:

	($000)
O&M	$143,505

Depreciation	40,512
Taxes other than income taxes	20,953
Interest on customer deposits	154
Return (including income taxes)	56,323
	$261,447

The only potentially controllable area is O&M, of which $93 million, or 65%, is wages and benefits: the majority of the remaining $50 million is necessary for the maintenance of our infrastructure and facilities and to provide service to customers. For example, the age of our underground infrastructure requires an ongoing financial commitment. And reducing our marketing expenditures will only sacrifice the sales growth we are counting on to help offset costs. The QUEST program that reduced our work force by over 120 employees leaves very limited cost cutting opportunities in the personnel area. Certainly, these opportunities nowhere approach the average annual incremental reduction of $5.3 million that is required to earn an 11% return on equity over the next six years. One would have to eliminate 90 positions a year to generate $5.3 million a year in cost savings; over a six year period this is 540 jobs, or about 40% of our total work force. Frankly, it cannot be done if the Company is to continue to operate safely, and provide the high quality service to which customers are accustomed and that the Department expects under its SQI provisions.

Q. Please explain the assumptions underlying your analysis.

A. The starting point in our analysis was the $251.0 million “monopoly distribution service revenue requirement" authorized by the Department.[23] We projected how the rates that were designed to meet this revenue requirement would increase over the period 1997-2002, by taking the most recent Wharton Economic Forecast Association ("WEFA") long-range forecast of GDP-PI, and offsetting the forecasted annual increases by the 2.0% X factor ordered. This produced annual increases ranging between 0.27% and 0.59%, and the resulting monopoly distribution service revenues over the next six years. To these revenues, we added the $9.1 million in special contract and competitive service revenues and the $1.3 million of "other operating revenues" (primarily late payment penalty revenues from C&I customers). Additionally, we included the gross margin effects of the 1996 net load additions of 1.6 Bcf, as well as the effects of the forecasted annual net load additions for the period 1997-2002. This growth in sales is optimistically forecasted at 2.3 Bcf per year. The result is an accurate -- albeit optimistic -- look at our annual operating revenues each year for the next six years.

Next we carefully reviewed our expenses, using the cost of service allowed by the Department as our starting point. The only adjustment we made to the Department's allowed costs was to add back the full amount of the 1997 union wage increase ($911,000) as well as the 1997 management increase ($1,025,000), and a normal level of overtime ($2,134,000). Although these costs were not allowed by the Department

[23] This is stated in the Order to be $249,944,006 (Order, p. 347, "Corrected Page"). The Department's Order erroneously excludes $1,117,030 of P&S facilities transferred to the CGAC which nevertheless receive PBR treatment.

in its Order, they are nevertheless costs that we will incur to run our operation.

In order to trend our operating costs forward, we used various multipliers. For example, for 1998 we trended wages and salaries by 4.0%, which is the increase we are committed to per the contractual agreement with our bargaining units; thereafter (1999-2002), we assumed wages and salaries would increase by GDPIPD, the inflation index allowed by the Department in this proceeding and also provided by WEFA. We trended medical costs at medical trend rates ordered by the Department to recompute PBOP costs (Order, p. 85). Many costs will remain fixed over the term (fixed leases, QUEST costs, etc.). All other O&M costs were trended using the GDPIPD forecast provided by WEFA. Pages 2-6 of Exhibit BGC-247 set forth the details and assumptions employed in our analysis.

I have already mentioned our aggressive sales growth forecast. In addition to the annual expense increase of $2 million in our marketing budget, this growth will not be achieved unless we invest, on average, $18.6 million per year (1997-2002) in new mains, services and meters. This is based on the assumption that we will pay dividends to Eastern equal to 50% of our earnings (75% is standard for the industry as a whole; the average for other Massachusetts LDC’s is 83%) and retain the remaining 50% of our earnings each year and reinvest them in the business. Given the reaction of Eastern Enterprises to the financial aspects of the Order, this is optimistic.

In addition to the capital requirements necessary to achieve our growth forecast, average annual investments in excess of $33 million are necessary to maintain the safety and reliability of our operations and continuing service quality to our customers.

Q. How will the Company fare if its petition for reconsideration is granted?

A. Using the same assumptions as detailed above, and assuming a $13.0 million rate increase and PBR plan with a 0.5% X factor, the Company's returns would be as follows (see Exhibit BGC-247, p. 7):

Year	Return on Average Common Equity
1997	10.4%
1998	9.9%
1999	9.9%
2000	10.0%
2001	10.0%
2002	10.4%

While these returns are below the level authorized in the Order, they provide us with a realistic incentive to “stretch” to achieve the 11% return allowed by the Department. We understand full well that this is the purpose of PBR.

Q. Does this conclude your testimony?

A. Yes.

Boston Gas Company
M.D.P.U. No. 96-50
Exhibit BGC - 248

Reconsideration Testimony of
Rebecca S. Bachelder

Testimony of
Rebecca S. Bachelder

Table of Contents

Exhibit List

Q. Please state your name, position and business address.

A. Rebecca S. Bachelder. I am Manager of Rates for Boston Gas Company, One Beacon Street, Boston, Masachusetts, 02108.

Q. Are there exhibits accompanying your testimony?

A. Yes, Exhibits BGC-249 through BGC-251.

Q. Were they prepared by you, or under your supervision and control?

A. Yes, they were.

Q. Are Exhibits BGC-249 through BGC-251 true and correct to the best of your knowledge and belief?

A. Yes, they are.

I. Purpose of Testimony

Q. What is the purpose of your testimony?

A. My testimony has four purposes. The first is to describe the revenue impact associated with the fixed price interruptible transportation ("IT") option and shareholder retention of IT margins included in the Offer of Partial Settlement ("Settlement") jointly filed by the Company, the Attorney General, the Department of Energy Resources, the Energy Consortium, Associated Industries of Massachusetts, and the National Consumer Law Center on behalf of Low Income Intervenors on November 15, 1996 and rejected by the Department in its Order of November 29, 1996. Second, I will address the Company's requested reconsideration of the X-factor in light of new evidence introduced by Dr. Lowry and the Department's inadvertent double counting of QUEST savings and additional throughput from unbundling. Third, I will compare the overall service quality penalty imposed on the Company in the Department's Order compared with the penalty imposed in NYNEX. Finally, I will present evidence on the fully embedded customer costs in accordance with the cost of service study approved by the Department and will compare the customer charges ordered over the six year life of the regulatory plan with the cost-based customer charges derived from this study.

II. Interruptible Transportation Pricing and Ratemaking Treatment

Q. Please describe the fixed price IT option incorporated in the Settlement.

A. The settling parties agreed that, in addition to the Company's standard offer IT agreement, the Company would offer a fixed price interruptible transportation tariff with pricing and availability specifications as follows:

(a) twelve month fixed pricing option for high load factor customers.

- option must be selected for entire twelve months.

- C $0.30 per MMBtu.

(b) nine month fixed pricing option for low load factor customers.

- C option must be selected for nine month period of April-December.
- C $0.62 per MMBtu.
- C negotiated value of service pricing in effect for January-March.

The definitions of high and low load factor customers would be consistent with those for the G-44 and G-54 rate classifications, assuming year-round gas use. Customers would be required to have installed dual-fuel capability or certify their willingness to accept the risk of interruption to select this service.

Q. Why was it necessary to package the fixed rate pricing option with the Company's revenue requirement and its retention of non-firm margin?

A. Because the fixed rate pricing option provides customers who require or are willing to assume the risk of less than firm reliability with significant discounts from the firm tariff rate and potentially from value of service pricing, the Company's revenue requirement needs to be set at a level to protect against losses resulting when existing firm customers select this option. Additionally, the ratemaking treatment for firm and interruptible service differs. Shareholders are responsible for ebb and flow in the number of customers between rate cases for firm load, whereas firm customers enjoy the majority of the benefits of IT service with a 75/25 margin sharing arrangement with shareholders for year-to year improvements over the prior year's threshold. As shown in Exhibit BGC-249, the Company determined that total firm revenues for customers at risk are $6 million. If the IT rate is offered without an accompanying change in ratemaking treatment for interruptible revenues, the revenue risk associated with the fixed rate IT offering is likely to be between $3 million and $6 million annually. The revenue requirement and IT ratemaking provisions of the settlement considered this risk to the Company.

Q. How did you determine the margin erosion potential?

A. During settlement discussions, we relied on our knowledge of our customer base and estimated approximately $2 million in margins (assuming we retained the IT margin) would be at risk from dual fuel customers converting from firm service to IT. We also assumed that this estimate was conservative. This number was presented to the settlement parties. We have subsequently verified this estimate in discussions with our marketing representatives.

Q. What process did you use to verify the estimate?

A. First, we determined the customers likely to choose this option. A number of firm customers are former interruptible sales customers who switched to firm transportation service when that option became available per the Department's Order in Boston Gas Company, D.P.U. 93-60. These customers found that firm transportation service, when coupled with third party gas, offered them savings over value of service priced interruptible sales service. The firm tariff also offered them price certainty and ease of selection not included in the value of service option. These customers have retained their dual fuel capability and are able to bear the risk of less than firm reliability. Additionally, the Company has data indicating that other existing firm customers have dual fuel equipment.

We examined the list of our customers known to have dual fuel equipment and, based on our knowledge of and discussions with customers, we assessed the risk of each customer switching to the fixed IT option. We also know these customers' load factors and annual usages. Customers with high load factors have an average firm transportation rate of $1.00 per MMBtu. A switch to the fixed IT price offered in the Settlement would yield savings of $0.70 per MMBtu. Similarly, a low load factor customer has an average FT rate of $1.40 per MMBtu with potential savings of $0.78 per MMBtu with a switch to the fixed IT price of $0.62 provided in the Settlement. From this information, we estimated the margin risk the Company would assume. This analysis is summarized in Exhibit BGC-

249.

As shown in this exhibit, under the Settlement fixed rate option, where IT margins would be retained by the Company, we determined that at least $2.0 million, and potentially $4.0 million in margin would be lost from firm customers who we know have dual fuel capability and could switch to the fixed IT rate. If the Company does not retain IT margins, an additional $2.2 million is at risk.

Q. Is this the entire risk of the fixed IT rate option?

A. No. The Company has incomplete information with regard to equipment installed at each customer's site. We do not know the extent of dual fuel capability in the commercial and industrial population overall. We also do not know the attitude of existing commercial and industrial customers toward risk of interruption in relationship with the attractive fixed price rates agreed to in the Settlement. There could be significant additional risk beyond those dual fuel customers we have identified.

III. Price Cap Productivity Offset

Q. With respect to the consumer dividend, is it true that the Company expects additional productivity gains as a result of its QUEST program?

A. Anticipated productivity gains are subject to factors such as negotiations[24] with the bargaining units representing over 70 percent of the Company's employees, and investments in technology. Additionally, the Company believes that the Department is double counting the benefits from QUEST by explicitly incorporating future savings into the consumer dividend. The Department approved in its Order, the Company's proposal to return all the benefits thus far realized from QUEST to firm ratepayers. Included in the national and regional TFPs calculated by Dr. Lowry, are reengineering efforts performed by gas LDCs since 1983. We conducted an informal survey of northeast LDCs included in the sample and verified that 12 LDCs out of the 19 have gone through reengineering programs over the last 10 years. A representative level of these reengineering productivity gains is already included in the TFP element of the productivity offset. The Department has inadvertently counted them twice in finding that the consumer dividend should be expanded to share anticipated QUEST productivity gains that are dependent on factors such as labor negotiations and other technology investments. The Company has provided to consumers all realized QUEST benefits and will be sharing future savings through the TFP and the consumer dividend. To explicitly account for them again as justification for expanding the consumer dividend beyond the 0.5 percent proposed by the Company is double counting.

Q. Is there a similar double counting of throughput in the expanded consumer dividend?

A. Yes, the Company has incorporated the unbundling benefits realized to date in its most elastic customer segment in its cast-off rates. These rates include the expanded throughput as denominators to the Company's cost of service. The proxy TFP ordered by the Department was specifically chosen to account for the impacts of throughput on regional productivity, and therefore includes the impact on regional productivity of increased throughput associated with unbundling in the northeast (which includes some of the most advanced jurisdictions in the country with respect to unbundling, i.e., New York and New Jersey). Most of the northeast states have unbundled their largest C/I customers, who typically have the most elastic demand, during the study period. Therefore, the rate of change in productivity associated with unbundling is already incorporated in the productivity index element of the productivity factor.

[24] Contracts with the bargaining units do not expire until 1999.

IV. Service Quality - Penalty Level

Q. What is the service quality penalty ordered by the Department?

A. The Department has ordered an aggregate service quality penalty of $4.9 million, which as shown in the table below is 2.0 percent of the Company's distribution service revenues.

Q. Is this comparable to the penalty imposed by the Department in NYNEX[25]?

A. No. The table below shows the potential penalty as a function of revenues for Boston Gas that is approximately twice the one percent ordered for NYNEX.

[25] The Department ordered a maximum one percent of revenues service quality penalty for NYNEX. NYNEX, D.P.U. 95-83-A, p. 19 (1996).

% of Revenues	Annual Penalty Percent	Annual Revenues $000	Maximum Penalty $000
NYNEX	1.0%	$1,745,193	$17,452
Boston Gas - Per Order	2.0%	$251,007[26]	$4,900
Boston Gas if proportionate to NYNEX	1.0%	$251,007	$2,510

V. Customer Charges

Q. Is there additional evidence with respect to customer charges that was not provided to the Department at the time of its decision?

A. Yes, the Company had not provided the Department with cost component

[26] Total distribution service revenues subject to the price cap:

Core revenue requirement recovered in base rates	$235,349,946	Compliance Exh. BGC-2, l.30.
Production and Storage collected in CGAC	14,452,000	Compliance Exh. BGC-3, pg. 73, l. 24.
Gas Acquisition Costs collected in CGAC	1,205,274	Compliance Exh. BGC-3, pg. 73, l. 25.
Total Distribution Revenues subject to the price cap	$251,007,220	

studies indicating the fully embedded customer costs and resulting customer charges from those studies. I have included a customer component study summary, incorporating the Department's Order in this case, as Exhibit BGC-250.

Q. Are the customer charges and pricing rules ordered by the Department in line with the embedded customer charges shown in the study?

A. Generally, no. As shown in Exhibit BGC-251, although the customer charge for the residential non-heating class will surpass 90 percent of the embedded level by the end of the PBR term, the remaining classes will languish below 75 percent, with the residential heating class at 53 percent. The largest commercial/industrial classes, which were at full cost customer charges in D.P.U. 93-60, are at 87 percent and 61 percent respectively for the low and high load factor customers.

Q. What is the implication of charging less than full embedded customer charges?

A. Customer costs that are not recovered through the customer charge are built into the volumetric portion of the rates. This creates a subsidy for low use customers paid for by higher use customers in the same rate class. Low use customers pay less and high use customers pay more for the same customer related costs.

Q. Does this conclude your testimony?

A. Yes.

BOSTON GAS COMPANY
D.P.U. 96-50
EXHIBIT BGC - 252

RECONSIDERATION TESTIMONY OF
DR. MARK N. LOWRY

Table of Contents

I. Purpose of Testimony

What is the purpose of your testimony?

My testimony has two goals. The first is to update my cost performance study to include results for 1995. The second is to present evidence on the precedents for consumer dividends and inefficiency factors in approved and active price cap plans.

II. Cost Performance Update

Please describe your cost performance update.

In my direct testimony I presented cost performance results for the Company's gas delivery services during the 1984-95 period. I present here an update of the results to include 1995. The research employed the same econometric cost function that I used to compute the results reported in BGC/MNL-1. The cost function is described in more detail in BGC/MNL-3.

Results are presented here for two measures of the Company's 1995 gas delivery cost. One is based on the cost reported in the Company's 1995 Uniform Statistical Report (USR) to the American Gas Association. The USR numbers reflect the expensing of all 1995 costs associated with the QUEST program, including those for program implementation. The Department has permitted Boston Gas to amortize QUEST implementation costs over five years. In addition, 1995 USR numbers do not reflect the annualized cost savings to the

Company's customers as a result of the QUEST program.

These characteristics of the reported results compromise the usefulness of the Company's 1995 USR cost figures as a gauge of its recent cost performance. The second 1995 cost measure employed in my cost performance update is proposed as a more relevant gauge. The measure reflects a five-year amortization of the 1995 QUEST implementation cost and the annualized QUEST program wage, benefit, and tax savings in accordance with the Department's order. The total adjustment to the reported total USR costs is $9.3 million. Details of this adjustment are found in Table 1.

Table 1

Adjustments to 1995 Cost to Annualize QUEST Reengineering Savings[27]

Amortization of QUEST Program Costs	**$5,101,297**
Wage & Salary QUEST Reduction	**3,880,841**
Health Care Expense	**235,751**
Dental Care Expense	**48,399**
Total 1995 QUEST annualization adjs.	**$9,266,288**

Please recap your previous cost performance result.

I reported in my direct testimony that the Company had incurred a cost overrun of $ 3.6 million (1.27%) in 1994. However, a standard statistical test revealed that this estimate was not significantly different from zero.

[27] Source: Boston Gas Company, D.P.U. 96-50, p. 388, schedule 2.

That is, the Company's cost did not differ significantly from that predicted for an average cost performer in the industry.

What are your results for 1995?

My updated results presented along with results for the previous years of the sample period in Table 2 and Figure 1. It can be seen that the Company's *unadjusted* cost in 1995 was estimated to be $ 4.0 million *below* the predicted cost of the average industry performer. This estimate isn't significantly different from zero. The *adjusted* cost for 1995 was a more substantial $ 13.3 million (4.57%) below the predicted cost of the average industry performer. This estimate *is* statistically significant. The evidence thus suggests that after considering the Department's Order regarding the net cost impact of QUEST, Boston Gas logged a superior cost performance in 1995.

Superior performance is, apparently, nothing new for Boston Gas. My model suggests that during the full 1984-95 period, investigated the Company turned in a statistically significant *superior* performance on four occasions. It never turned in a statistically significant *inferior* performance. On average, the Company's cost was *below* the predicted cost of the average industry performer by 0.98 % during the sample period even without adjustments to the USR data. The analogous figure with the

adjustments that the Company has presented in this proceeding was 1.61 %.[28]

---

[28] **Adjustments were also made for strike-related expenses in 1993 and for extraordinary weather breakages in 1994. These adjustments are discussed in BGC/MNL-3.**

III. Consumer Dividends and Inefficiency Factors in Approved Price Cap Plans

Why are you presenting evidence on consumer dividends and inefficiency factors?

In its November 29 Order, the Department approved a package of customer benefits in the price cap plan for Boston Gas. It includes a consumer dividend of 1% and an inefficiency factor of 1%. Both factors have the same values that the Department approved for NYNEX in 1995. This is surprising in view of the exceptionally rapid TFP growth trend of local exchange carriers in recent years and the more normal TFP growth trend of northeast gas distributors. The Department presents some explanation for assigning the Company the same consumer dividend as NYNEX. There is no companion explanation for why the Company should be assigned the same inefficiency factor. To appraise the reasonableness of these plan provisions, it is useful to inspect the analogous provisions in other price cap plans. No evidence of this kind has yet been presented in this proceeding.

Do you consider yourself to be an expert on these price cap plan provisions?

Yes. The group which I direct monitors price cap regulation around the world. I have authored several wide-ranging studies on price cap

regulation, including the influential "Price Cap Designer's Handbook" which is published by the Edison Electric Institute.

What data have you gathered on these plan provisions?

I surveyed all approved price cap plans in our possession to examine their X-factor terms. Our sample covers all of the price cap plans that I am aware of for major electric, gas, telecom, and oil pipeline companies. Plans in the United States, Australia, Mexico, and the United Kingdom are included. Fifty-eight plans were surveyed in all[29]. Thirty-four of these are currently active. I define an active price cap plan as one that is using a price cap index to restrict the escalation of rates for some services *in the fall of 1996*.

What did your survey reveal about the accumulated inefficiency factors in active price cap plans?

My survey revealed that *only one* active plan has an explicit inefficiency factor. That is the plan for NYNEX in Massachusetts.

---

[29] In arriving at this tally I do not count separately either the plans for the several power distributors in England and Wales, or the Federal Communications Commission plans for the interstate services of local exchange carriers. I have also excluded from the survey the plans in several states for smaller LECs. These tend to have lower X-factors. I treat the price cap plan of the Federal Communications Commissions for the LECs as two plans: one with an earnings sharing mechanism and the other without.

How do you explain this finding?

I believe that the accumulated inefficiencies of utilities are part of the grounds for expecting accelerated TFP growth during price cap plans. Accordingly, they are already reflected in the X-factors either implicitly or in an explicit consumer dividend.

What did your survey reveal about the consumer dividends in approved and active price cap plans?

Only a few plans have *explicit* consumer dividends. All are for local exchange carriers (LECs). These are reproduced here for convenience.

Utility	*State*	*Stretch Factor*
Ameritech	IL	1%
Ameritech	OH	0.2%
NYNEX	MA	1%
NYNEX	ME	1%
Bell Atlantic	PA	0%

The average explicit consumer dividend is 0.64%.[30]

[30] Pennsylvania considered an explicit consumer dividend in its Order approving a price cap plan for Bell Atlantic and rejected the idea. The Pennsylvania Public Utility's Commission stated that, "We are faced with both the uncertainty of the stretch factor theory and the relative imprecision of the estimated factor values available to us in this proceeding. Thus, we specifically reject the inclusion of a stretch factor in the overall inflation offset of Bell's PSM formula." "Opinion

An X-factor contains an implicit consumer dividend whether or not it contains an explicit one. Is it possible to calculate these?

To compute an implicit consumer dividend, it is necessary to adjust the X-factor for any explicit inflation differential or inefficiency factor along with the TFP growth trend of the relevant industry. Consensus on industry TFP trends is uncommon. One exception is the 0.3 % average annual growth trend for the U.S. private business sector which has been calculated by the Bureau of Labor Statistics of the U.S. Department of Labor.

There is also considerable consensus on the TFP growth trend of LECs, which has been the subject of several TFP studies. The best available estimate of the LEC TFP trend is the 2.4% average annual growth rate presented by Dr. Laurits R. Christensen in recent testimony before the Federal Communications Commission.[31] This is six times the 0.4% long-run growth trend which the Department has adopted in this proceeding as the TFP trend of northeast gas distributors. The exceptional TFP growth of LECs reflects rapid change in technologies for both the provision and use of telecommunications services. Comparable developments are not occurring in natural gas distribution or most other sectors of the U.S.

---

and Order, P-00930715, June 23, 1994, p. 76.

[31] See Laurits R. Christensen, Philip E. Schoech, and Mark E. Meitzen, "Productivity of the Local Exchange Operating Telephone Companies Subject to Price Cap Regulation," Christensen Associates, May 3, 1194. This updates the 2.6% annual growth trend which Dr. Christensen noted in his 1995 DPU testimony for NYNEX.

economy.

X-factors in telecom price cap plans are sometimes elevated by input price inflation differentials. To the best of my knowledge, the trend in the input prices faced by larger LECs is similar to that of the economy. However, a few Commissions have drawn different conclusions from the evidence and have approved inflation differentials. These have substantially raised the X-factor in a few cases.

The attached Table 3 presents the details of my computation of implicit X-factors in active U.S. price cap plans for LECs. Table 3 takes the X-factors from the selected plans and removes any "extra" terms such as an inflation differential or (in Massachusetts) an inefficiency factor.[32] A 2.1 % TFP growth differential is then subtracted from this net figure. This is the difference between Dr. Christensen's 2.4% TFP trend for LECs and the 0.3% TFP trend of the U.S. private business sector.[33] The result is an estimate of the implicit consumer dividend in the telecom plans surveyed.

What are the results of this exercise?

---

[32] It can be seen that there are inflation differentials in plans in Illinois, Maine, and Massachusetts.

[33] The use of a TFP trend differential is common in telecom price cap plans because of their use of inflation measures like the GDPPI.

Inspecting the results of Table 3, it can be seen that the average value of the X-factor in the price cap plans surveyed is 2.96%. The average value of X net of the "extras" (input price differentials and accumulated inefficiencies) is 2.75%. By subtracting the 2.1% TFP growth differential, it can be determined that the average implicit stretch factor in the plans surveyed is 0.65%. This is close to the stretch factor proposed by Boston Gas in this proceeding. Yet it applies to a base industry TFP growth trend of 2.4% that is six times the 0.4% proxy found by the Department for northeast gas distributors.

IV. Conclusions

What do you conclude from this research?

I conclude that the 1% consumer dividend approved for the price cap index of Boston Gas is at the high end of precedent considering that the Department's accepted TFP growth trend for northeast LDCs is one-sixth that of LECs. The combination of a 1% stretch factor and a 1% accumulated inefficiency factor creates a TFP hurdle for Boston Gas relative to its underlying industry TFP trend that is far higher than that in any American price cap plan I know of. This is surprising in light of the Company's solid recent cost performance.

The lack of a convincing empirical basis for these challenging terms raises

the specter of a regulatory system in which plan parameters, which apply for many years, are chosen arbitrarily. In the long run, this will weaken the performance incentives and resultant performance gains that price cap regulation can foster.

Does this conclude your testimony?

Yes it does.

Boston Gas Company
Petition for Reconsideration
Exhibit BGC/RMM-1
Witness: Robert M. Miller

Reconsideration Testimony of Robert M. Miller

Q. Did you testify in the initial hearing D.P.U. 96-50?

A. Yes, I did. As Vice President of Operations & Marketing Support, I testified as to the Company's quality of service and the service quality index ("SQI") proposed by the Company as part of its Performance-Based Regulation plan.

Q. What is the purpose of your reconsideration testimony?

A. After reviewing the Phase I Order in D.P.U. 96-50, I am providing information that was not available to the Department during Phase 1, and which would have substantially affected the Department's decision regarding the SQI. My comments will focus on the impact the SQI, as ordered by the Department, will have on the Company's operations. In particular, I will address the Department's order regarding the measurements for Telephone Service Factor ("TSF"), Consumer Division Complaint Cases, and Consumer Division Customer Adjustments.

There are issues regarding the definition of measurements and the magnitude of the potential penalties, that, unless, clarified or modified, will have unintended consequences from what the Department may have intended.[34] In addition to presenting this new evidence and seeking clarification from the Department as to their intent, the Company will suggest alternative approaches for measurements in these areas that preserve the level of service quality provided by the Company as it operates in a Performance-Based Regulatory framework.

Finally, given the significant changes to the SQI proposed by the Company, I will recommend a change in the measurement period to allow the Company an opportunity to appropriately align its resources to operate under the new framework.

Telephone Service Factor

Q. Please describe the TSF proposed by the Company and the modifications made by the Department.

A. The Company recommended a measurement that was tied to its service goal . The TSF target was to respond to 90% of emergency

[34] "A well designed price cap plan must include some form of protection against a reduction in service quality for monopoly customers." Order, p. 304.

calls and 80% of service and billing calls within 40 seconds from the time the customer selects an option in the Teloquent Phone System. Company Br. at p. 61, Appendix A. The TSF would be one component of a single benchmark used to determine overall Company service quality with a determined weight of 30% of the total SQI measure. Company Br. at p. 65. The Phase I Order modifies this measurement in two ways. First, the TSF becomes a stand alone measure. Second, the Department significantly stretched the performance target to the following:

Emergency Calls	95% answered in 30 seconds
Billing & Service Calls	80% answered in 30 seconds

Q. Did the Department have sufficient information regarding the Company's performance in answering telephone calls with its Teloquent system to establish the benchmark?

A. No. The order was based upon very limited information. The only numerical support for TSF was contained in Exhibit DPU-103, where the Company provided four months of data on its response to customer calls. Since the system had only recently been installed in January, 1996, this was the only data the Company had available. That data, for the period March 1996 through June 1996, did not accurately reflect anticipated annual call volumes. For example, as can be seen in the attached Exhibit 1, the Company experiences significant call volumes in the late August and early September time frame to set up new accounts for the influx of students in our service area.[35] Nor does the record reflect the call volume associated with budget billing solicitation and finalization, Heating Service Plan solicitation, or the initial cold weather no-heat calls that all occur during the fall months. Finally, the record does not reflect the Company's call activity during severe winter conditions.

As seen in Exhibits 2 & 3, for the four months July through October, the Company experienced an increase of 10,371 or 29% in emergency calls, and an increase of 55,020 or 22% in service and billing calls compared to the four month March through June period. In total this is an increase of 65,391 calls or 23%. In addition, the Company received 12,539 emergency calls and 75,902 service and billing calls in November, 1996. This November call volume is significantly higher than any other month except October.

Q. How will the target levels set by the Department affect the Company's operations and customer service quality?

[35] Approximately 50,000 new accounts are set up every September.

A. To meet the goal ordered by the Department would require the Company to add over 15 new customer inquiry representatives. (See Exhibit 4) Staffing would need to be permanently increased to handle peak call volume periods that only occur at only certain times of the year. This cost, which is not recoverable in ratebase over the 5 year life of the PBR Plan, outweighs the potential $700,000 penalty such that the Company will be driven to give up on achieving the benchmark and shrink the inquiry area to offset that penalty. This will result in a lower TSF than proposed; yet one which meets a majority of our customer's needs. We do not believe this is what the Department intended.

Another unintended consequence of setting the TSF at an unreasonable level is to discourage Company personnel from spending an appropriate amount of time with the customer to adequately assist them. Our commitment to Voice Recognition Unit ("VRU") technology was based on its ability to streamline our telephone inquiry process, forward customers to the phone representatives with the appropriate skills as soon as possible, and to allow us to utilize the entire staff from multiple locations seamlessly. This technology is a contributing factor to the decrease in customer complaints to the DPU in 1996. Utilizing the Teloquent

system allows us to spend less time directing calls and more time resolving the customer's concerns.

It was not, and is not, our intent to rush the phone representatives off the phone before they have adequately satisfied the customers' concerns. Setting an unreasonable goal will cause this to happen and will drive higher consumer complaints, some of which will then become cases at the Consumer Division, another proposed measurement area.

Q. In its Order, the Department states that the Company's customer service personnel will become more efficient at answering customer telephone calls over time. Do you agree with this statement?

A. No. This statement can only be predicated upon the Department's belief that our phone representatives are new at the process of handling customer calls. In fact, the average years of experience for phone inquiry personnel is 12 years. What is new in this area is the VRU itself, which provides for enhanced customer communication links and management tools, the benefits of which are already reflected in our lower customer complaint levels. Future efficiencies will be directly related to capital investments in additional technologies , or personnel, neither of which was a part of the case

<u>**or recoverable through base rates over the life of the PBR Plan .**</u>

<u>**Q. Based upon this new information what would be your recommendation for a TSF measure?**</u>

<u>**A. The Company believes that the TSF it proposed on brief is the appropriate measurement mechanism. The Company bases its position on its more expanded experience as well as the experience of other companies that have migrated from traditional phone inquiry systems to VRU's. As Exhibits 2 and 3 show, the Company's performance from March through November, which excludes the winter period where we normally experience a higher level of emergency calls, was 95.3% within 40 seconds for emergency calls and 73.4% for Billing and Service calls within 40 seconds. This is below the target level recommended by the Company.**</u>

<u>**Q. The Department's Order targets two distinct measures, one for billing and service and one for emergency, and there is a $700,000 penalty associated with non-performance, is it clear to you how these separate measures relate to the penalty?**</u>

<u>**A. No. The Order ties a potential maximum penalty of $700,000 to this measure in its entirety. Yet, the measure is comprised of two distinct components. The Order implies that for each 1% below the target goal we would be penalized $140,000. Our understanding is**</u>

that the penalty would be applied to the absolute value of the composite of these two indices. For example an over achievement in one area would offset an under achievement in another area (i.e. using the ordered performance levels, a 97% achievement in the emergency goal would offset a 78% achievement in the billing and service goal). The Company believes that this is the most appropriate approach since the same resources are utilized to respond to both types of calls. The maintenance of the billing/service goal should never take precedence over the goal of responding to the safety of our customers.

Consumer Division Complaint Measurements

Cases

Q. What is your understanding of the Department's Order and its impact on the process operations of the Customer Transactions department?

A. In its Order the Department stated that " ... the raw number of complaints in and of itself does not necessarily reflect poor quality of service." and goes on to say that ".. the increased collection efforts could be contributing to the total number of calls received by

the Consumer Division that are tabulated as complaint calls." and "... we find that since 1994 there has been a 15% drop in the number of Consumer Division complaints concerning Boston Gas." Order at p. 93. Yet, on page 307-308 of the Order, the Department orders a performance measure regarding customer complaint cases. The measure is such that the Company's cases must represent no more than 50% of the cases handled by the Consumer Division in any calendar year for all Massachusetts LDCs, including the Company.

Q. Is the Department's definition of a case clear to the Company?

A. No. It is not clear to the Company whether cases, as defined in the Order, include credit problems as well as billing issues. By credit problems, I mean instances where a customer does not dispute a Company bill or allege that the Company violated Department regulations, but rather, is unable to make adequate payment arrangements to avoid termination of service or to be turned on after an off for non-payment. Many times, customers with financial difficulties seek Department assistance in arranging less than acceptable payment agreements.

If the Department's intent is to include credit problems in the measure of our performance on cases, it could have an unintended

outcome. For instance, the Company could seek to reduce the number of cases by being less aggressive in its collections efforts. This would result in both higher bad debts and higher rates for all firm sales customers. Perversely, the Company's incentive is to offset the penalty by allowing bad debt to rise and avoid cases ever going to the Department.

Further, the criteria upon which the Department classifies a customer contact as a case as opposed to a "referral" is not clear. Historically, the Consumer Division staff has had great latitude in categorizing customer contacts as either referrals or cases. Since the decision of the Department's staff as to what constitutes a case has a certain level of subjectivity, it is important that the Company understands the criteria for the Department's determinations. The Company must also have assurance that this criteria is consistently applied to all LDCs.

Q. What new evidence does the Company have regarding its performance on consumer complaint cases before the Department?

A. The record in this case does not support Consumer Division cases by themselves as an output measure of the Company's performance. Cases are not necessarily a reflection of the Company's

performance. In fact, as shown in Exhibit 5, in over 70% of the informal and adjudicatory hearings associated with cases during 1994 through 1996, the Company was found to have complied with the Department's Consumer Protection regulations. Additionally, resolution of cases before the Consumer Division can span multiple years. Consequently, the Company may be penalized in one year and found to be correct in the procedures it followed in a subsequent year with no offset to the prior years results.

Upon reviewing the Department's cases for April and August of 1996,[36] the Company identified several accounts which should not be considered cases by the Department. As shown in Exhibit 6, these cases include requests for billing information and accounts where a customer cannot make an acceptable payment agreement with the Company, and so, contacts the Department to arrange less than acceptable payment agreements.

Q. Is the information for daily management of cases referred to the Department readily available to the Company

A. No. An operational concern of the Company is the prompt and

[36] The Company chose these two months as a random sample representing different times of the year.

accurate availability of records from the Department. If the Company is to manage a process based upon records the Department keeps, the statistics for the Company, as well as those for other utilities, need to be kept current. Since the timeliness of this information has not historically had such consequence to the utilities' bottom line, delays in the availability of data has been acceptable. For example, information for the period July, 1996 through September, 1996 was only recently made available to us in December, 1996. Now, however, this performance measure requires constant communication with the staff so that we are current on not only the Company's case load status, but that of other utilities as well.

Since prospectively, the Company will not know what the performance of the other LDC's will be, it can not proactively establish an internal goal for its staff to work towards on a day to day basis. For instance, we could set a goal of no more cases than the prior 12 month period, If however during the year the other utilities were to improve slightly, we will have maintained our performance but would still be subject to a penalty.

Q. Is a penalty of $700,000 appropriate in relation to the percentage of customers that are represented by cases?

A. No. The disproportionate penalty for this customer group will encourage the Company to find business practices that are not in the best interest of all customers.

According to Department statistics, excluding sanitary code violations, the Company has had 527 cases since January through November, 1996. This represents less than .1% of our customers. Assuming average consumption and average margin for residential customers of $528.62 annually, these customers represent approximately $300,000 in potential margins. Hence, the potential penalty is more than double the potential earnings from this customer group. In addition, since the absolute number of cases is small compared to the customer population, it would only take a small rise in total cases compared to other utilities for the Company to be exposed to a penalty situation. Thus, the Company's incentive is not necessarily to improve its service quality, but rather, to placate the small group of customers so that the Department never hears from them.

Q. Do you expect industry restructuring to have an effect on consumer complaint statistics?

A. Given the proposed restructuring of the industry and the

introduction of brokered gas to residential customers over the proposed Performance-Based Regulation Plan, the Company expects to see a rise in consumer complaints and cases. The shear magnitude of the changes in the industry are certain to drive additional customer complaints.

Adjustments

Q. What is your understanding of the Department's Order on billing adjustments and its impact on the process operations of the Customer Transactions Department?

A. In its Order, the Department stated that " ... the evidence in this case shows that the Company has realized a 75 percent drop in billing adjustments in 1995 and a subsequent drop in 1996. We find that Boston Gas is operating in accordance with the Department's goal of encouraging all utilities to improve their quality of service and thereby reducing the number of abated bills." (Order p. 94) Yet later, on page 308 of the Order, Department orders a performance measure regarding bill adjustments. The measure is such that the number of consumer division bill adjustments must represent no more than 65% of the dollar value of adjustments by the Consumer Division in any calendar year for all Massachusetts LDCs, including

the Company.

Q. Is the Department's Order on adjustments clear?

A. No. It is not clear if the measure is based on the number of adjustments or the dollar value of adjustments.

Q. What are your overall concerns regarding adjustments ordered by the DPU as a result of customer complaints, and what effect will it have on the operations of the Company?

A. If the measure requires that the Company's gross dollar value of adjustments be no greater than 65% of the total adjustments of all Massachusetts LCD's, the Company's concerns are multiple. First, there was no discussion or record support to justify this Order. Second, the measure is against the performance of other utilities and the Company is not necessarily in control of its own destiny. Third, adjustments are often the result of a case; hence, the Company is being measured twice, and potentially penalized twice, on the same activity. Fourth, our experience with what the Department considers an adjustment does not always reflect a determination that the Company has violated any of the Department's regulations, or that the Company had made an error in calculating the bill.

The Department's standards for determining when an adjustment is warranted is set forth in footnote 49 on page 86 of the Order: "In disputed billing cases, if the Department determines that a company has violated the Department's regulations concerning consumer protection (220 C.M.R. § 25.00 et seq.), the disputed billing amount is abated." The Company should not be penalized for following proper procedures and regulations. Exhibit 7 is one example of a good will adjustment that counted against us in our adjustment totals.

Another issue that impacts the Company is the inappropriate inclusion of commercial accounts in our adjustment records. Despite stating that an adjustment is only made when there is a finding that the Company has violated the Department's regulations concerning consumer protections, 220 C.M.R. 2500 et seq., and the fact that those regulations exclude commercial/industrial accounts, the Department continues to include commercial/industrial accounts in our statistics. One large abatement for a commercial account can skew the results for the Company. As Exhibits 7 and 8 show, this happened to the Company in 1994.

Finally, adjustments as currently defined seem to include cancellations and re-bills. These are a reflection of the Company's

ongoing effort to provide more accurate billing and are already subject to performance measurement in the billing portion of the SQI.

Q. Is the information for daily management of adjustments readily available to the Company?

A. No. The Company has the same concerns about the access to Department statistics and its ability to proactively manage adjustments as it has about cases.

Q. Is a $700,000 penalty based upon the value of the abatements an appropriate penalty?

A. No. The Company has processed 65 abatements totaling $45,026 through November , 1996. (Exhibits 7 and 10). Such a disproportionate penalty for this customer group will encourage the Company to find business practices that are not in the best interest of all consumers. For instance, it is likely that the Company would begin to grant inappropriate bill adjustments to customers on their first contact with the Company for no other reason than to avoid having them contact the Department. Furthermore, on those occasions where a customer did contact the Department, the Company would be placed in the untenable position of having to choose between customer satisfaction and the bottom line impact of a substantial penalty. Rather than work to satisfy the customer's concerns, the Company would have an incentive to challenge every Department request to adjust a bill and appeal every adverse hearing decision, in the hope of avoiding the adjustment. This is not in the best interest of the customer, the Company, or the Department; each of whom should be working towards an expeditious and equitable solution for the customer, rather than engaging in a costly and time-consuming administrative process.

Consumer Division Complaint Measurements Summary

Q. Do you believe that cases and adjustments as defined in the Commission's order are an appropriate measure of the quality of service the Company provides to its customers.

A. No. For all of the reasons outlined above the Company does not believe that cases or adjustments are appropriate measures of the Company's level of service.

Q. What would be a more appropriate measure reflecting the Company's overall effort to resolve consumer complaints?

A. If the Department insists that a measure be included in the

Company's service quality index for complaint statistics the Company suggests the following:

The number of Company cases and second referrals in a given year will be no more than 95% of its previous three year rolling average of cases and second referrals. (See Exhibit 11)

Such a measure would be within the control of the Company, would allow for proactive goal setting, and it would be consistent with the Department's mandate to ensure the continued delivery of safe and reliable service to the public and protect against a reduction in service quality for monopoly customers.

TIMING

Q. In its filing, the Company proposed that the measurement period for its SQI commence on July 1, 1996. Is this time frame for the measurement period still appropriate?

A. No. As a result of the Department's modifications and the elimination of weights in the service quality index calculation, the Company proposes an initial measurement period of July 1, 1997 through June 30, 1998 for effect in year two of the PBR Plan. This will allow the Company a fair and just opportunity to modify its behavior in an effort to meet the mandated performance targets.

Q. Does this conclude your testimony?

A. Yes, it does.

Boston Gas Company
Petition for Reconsideration
Exhibit BGC-264
Witness: Kelly

Reconsideration Testimony of Jane M. Kelly

Q. Ms. Kelly, did you testify in the initial hearings D.P.U. 96-50.

A. Yes, I did. As Director of Accounting for Boston Gas Company, I testified to the Company's revenues, expenses, and need for adequate "cast-off" rates which would allow the Company to compete in a Performance Based Regulation (PBR) environment.

Q. Please summarize the Company's reasons for petitioning the Department to reconsider its calculation of the Company's revenue deficiency in the November 29, 1996 Order.

A. The Company believes that the Department ignored its own precedent both in deciding and calculating certain adjustments, and made mathematical errors in computing the Company's revenue deficiency. In addition, the Company believes the Department ignored the difficulties in establishing the Company's revenue requirements as it transitions from cost of service to performance based ratemaking. The purpose of my testimony is to:

- **highlight inconsistencies in the application of Department precedent;**
- **address the recalculation issues; and**

! present new evidence in support of certain adjustments.

A revised cost of service incorporating the items for which we seek reconsideration is contained in Exhibit BGC-265.

Q. Are there exhibits accompanying your testimony?

A. Yes. They are exhibits BGC-265 through BGC-280 for identification.

Q. Were these exhibits prepared by you or under your supervision and control?

A. Yes, they were.

Q. Are each of these exhibits true and correct to the best of your knowledge and belief?

A. Yes, they are.

Rate Base

Q. Is the Company asking the Department to reconsider its decision to exclude 1996 System Renewal Investments from rate base?

A. Yes, it is. I testified in D.P.U. 96-50 that Boston Gas would invest $28,056,000 in 1996 to maintain and replace its aging distribution system, which is the second oldest in the nation. Exh. BGC-38, p. 13. The Company's actual system renewal investments through November 30, 1996 total $27,565,354. By year-end 1996, the total

investment will exceed $29,000,000. I am submitting copies of the 1996 system renewal work orders for those jobs over $50,000. Given this new evidence (Exh. BGC-266) which confirms that the adjustment is "known and measurable," we request that the Department reconsider its decision to exclude these additions from rate base.

There is another reason for reconsideration: the change in circumstances resulting from the Department's decision to defer implementation of PBR until November 1, 1997. The initial adjustment was intended to bridge the transition from Cost of Service to PBR. By extending the implementation of PBR, the financial impact on the Company from excluding these investments is substantially increased. The exclusion of these investments over the term of the PBR plan results in foregone revenues (return and depreciation) on a net present value basis, of $10 million, as shown on Exhibit BGC-267. In other words, since the Company cannot begin recovering its investment until November 1, 2002, the cumulative impact on the Company is $10 million.

The Department's decision to postpone PBR implementation until November 1, 1997 has another impact as well, based on the fact that

the Company will spend an additional $27 million in 1997 on system renewal investments. Exh. AG-14. These investments support the Company's commitment to safe and reliable service, are not discretionary, and are consistent with those investments made from 1993-1995, which the Department found to be prudent. Order, p. 24. By deferring PBR for a year, the Company's cast-off rates will fall even further behind as the Company is denied a return on these 1997 investments, and the ability to recover their costs through depreciation charges, until November 1, 2002. While we are not asking that these investments be included in rate base, they provide further justification for including the 1996 investments.

Q. Is the Company also requesting reconsideration of the exclusion of its 1996 investments in its Performance Measurement systems?

A. Yes. Through November 30, 1996, the Company has invested $1,582,000 in Performance Measurement systems that are currently in service and operational. This includes $1.4 million for "COMPAS," the Company's integrated purchasing, materials management, and accounts payable system, and $130,000 for "Hyperion," the Company's budgeting and forecasting system. Exh. BGC-268. The other two systems we had asked be included (the Activity Based Management System and the Data Warehouse) are not yet

completed, although we have invested $200,000 in their development. Both have been delayed by the need to install the Broker Management System by December 1, 1996. To date the Company has invested $1,559,000 in this system, and it is now in service. We are not asking that it be included, due to the Department's prior ruling excluding evidence regarding its existence.

As with the System Renewal Investments, the COMPAS and Hyperion system investments are prudent and fully operational. The Department's refusal to acknowledge the transition from cost of service to PBR again creates a financial hardship. Disallowance of these investments, over the life of the PBR plan, results in foregone revenues, on a net present value basis, of $2.1 million. Exh. BGC-269.

Expenses

Q. Please explain the Department's error in computing the union wage adjustment.

A. Past decisions of the Department -- including the Company's last two litigated cases -- clearly hold that a utility is allowed to include in cost of service the entire union wage increase if it is scheduled to occur prior to the mid-point of the rate year. E.G., Western

Massachusetts Electric Co., D.P.U. 86-280-A, p. 74 (187). See Exhibit BGC-270, which contains relevant excerpts from the Company's last two litigated rate cases, D.P.U. 93-60, D.P.U. 88-67. Otherwise the new rates would be deficient and would not fully compensate the utility for the wage costs it will incur during the pendency of the new rates. As the record demonstrates (Exhibit AG-147), the 1997 union wage increases, per the agreements with the various bargaining units, are effective prior to the mid-point of the rate year (June 1, 1997). The Department erred by only granting 6/12's of the total 1997 union wage increase. Order, p. 49, n. 26. The Company was granted a full year's increase in its prior rate cases (D.P.U 93-60 and D.P.U 88-67) and the record does not support any deviation from this precedent. Since the change was not explained, the Company assumes that the Department simply erred, and will restore the balance of the 1997 wage increase, $911,069. If the Department intends to establish a new standard, we would object to it being used here without prior notice.

Q. Is the Company requesting reconsideration of the 1997 management compensation increase?

A. Yes, as I stated in my initial testimony, Boston Gas has long been committed to keeping compensation increases for union and

management in parity, a policy we consider necessary to attract and retain high-quality management employees. Exh. BGC-38, p. 22 and Exh. BGC-50. In its Order, the Department found that there is an historical correlation between union and nonunion annual payroll increases and that "Boston Gas's [management] compensation expenses are comparable to those of other New England utilities and companies in its service territories which compete for similarly-skilled employees." Order, pp. 42 and 48. As I mentioned in my initial testimony (Exh. BGC-38, pp. 9-10; p. 47), I excluded the 1997 management increase from the cost of service in our filing, on the premise that it would be covered by the Company's initial PBR filing. When the Department postponed the implementation of PBR to November 1, 1997, the Company's ability to recover the management wage increase in PBR was lost. Since cost of service principles will now apply for another year, I am submitting new evidence (Exh. BGC-271), in the form of a memo from the Company's President, Mr. Messer, to make clear that the Company is committed to a 1997 compensation pool in the amount of $1.2 million for the management employees. Two exhibits already in the record also support the commitment: Record Request AG-5, and Exhibit AG-14, the Company's 1995 Five Year Strategic Plan, which incorporates the commitment in forecasted wages and salaries. Based on these

exhibits and the memo from Mr. Messer, as well as the delay in implementing PBR, the Department should adjust the Company's cost of service to include the $1,024,800 management wage increase that will occur in January, 1997.

Q. Is there an error in the Order regarding the FICA tax adjustments for the 1997 wage and salary increases?

A. Yes. Department precedent allows for the recovery of the FICA taxes on known and measurable wage and salary increases. Commonwealth Gas Co., D.P.U. 87-122, p. 65 (1982). Exh. BGC-272 contains an excerpt from D.P.U. 88-67 showing this adjustment. In the Department's computation of the 1997 union wage increase, it appears the corresponding adjustment for FICA taxes was inadvertently omitted. The 1997 FICA increase (which encompasses a full year of the 1997 union and management increases) is $167,807. Exh. AG-5.

Q. Is the Company asking the Department to reconsider its denial of the overtime wage adjustment?

A. Yes, it is. The Department found that the Company had not demonstrated that its test year overtime figures were unrepresentative. Order, p. 45. The Department also noted the difficulty in distinguishing among weather related overtime

reductions, QUEST-related reductions, and the overall downward trend. We ask that the Department reconsider its order in light of the new evidence on 1996 overtime that I have included in Exhibit BGC-273. The 1996 results reflect the downward impact of the QUEST program on overtime, yet are consistent with other years, excluding 1995 and 1993 (which was higher than normal as a result of the labor stoppage). It also confirms that the number of overtime hours in 1995 was abnormally low. Accordingly, based on the new evidence, we have revised the adjustment downward, and based it on the difference between the 1995 overtime hours and the actual 1996 figures. The amount of the adjustment confirmed by the new 1996 evidence is $2,133,597. This analysis demonstrates that the 1995 overtime level is not representative of the overtime levels that can be expected to occur in the 1997 rate year and beyond.

Q. The Department reduced the Company's cost of service for wages, benefits and taxes associated with 12 unfilled positions resulting from the Company's QUEST initiative. Is the calculation correct?

A. No. The Department did not apply the Company's O & M percentage of 85.4% to the adjustment for FICA, state unemployment taxes and federal unemployment taxes. The adjustments should be as follows: FICA: $53,514 * 85.4% = $45,701; state unemployment taxes: $7,128

*** 85.4% = $6,087; federal unemployment taxes: $672 * 85.4% = $574. The corrections result in an increase to the Company's cost of service of $8,952.**

Q. Did the Department err in its calculation of bad debt expenses?

A. Yes. The Department made two mistakes in calculating bad debt expenses. The first is an omission, based on the fact that in order to derive the "test year" bad debt expense, one multiplies the appropriate uncollectible percentage by "operating revenues." In making that calculation, the $8,017,131 in bad debts that was ordered to be recovered through the CGAC was omitted from operating revenues. Since CGAC revenues are a component of operating revenues, this omission understates the bad debt adjustment. In other words, the Department erred in not including the CGAC recoverable bad debt amount in operating revenues when it computed bad debt expense. The Department made the identical error when it failed to include $1,174,030 of Production and Storage (P & S) expenses that have been transferred to the CGAC. To correct these omissions, the operating revenues used to compute bad debt expense should be increased by $9,191,161. This results in additional allowable bad debt expense of $197,610.

<u>In addition, we believe that the Department improperly ignored precedent when it rejected the Company's lagged methodology. In support of this request, I would point to Exhibit BGC-274, which was provided to the Department in D.P.U. 93-60, that confirms the existence of the lag. The Company believes that the change in methodology without prior notice is improper, and is unsupported by the evidence. Accordingly, we ask that the Department reconsider this aspect of its Order as required by New England Telephone Co. v. Department of Public Utilities, 371 Mass. 67, 84 (1976) (change requires prior notice); Boston Gas Co. v. Department of Public Utilities, 367 Mass. 92, 104 (1975) (utilities entitled to consistent treatment).</u>

<u>Additionally, we request that the bad debt calculation be updated for the revenue requirement adjustments resulting from the Company's motion for reconsideration.</u>

<u>Q. Does the Company object to the Department's decision regarding cellular telephones?</u>

<u>A. Yes, it does. The Department rejected the Company's method of annualizing the cellular phone charges even though it accepted the Company's similar methodology in annualizing the QUEST wage and</u>

benefit savings. In addition, new evidence shows that for the twelve months ending November, 1996, cellular phone charges total $807,512, which is within $2,404 (0.25%) of the amount requested in the Company's original Cost of Service. Exh. BGC-275. The new evidence clearly demonstrates that the 1995 cellular phone expense is unrepresentative of the levels presently being incurred and that can be expected in future years and supports the Company's proposed adjustment of $498,395.

Q. Is there an error with regard to the allowed rate case expense?

A. Yes, there is. On page 79 of the Order, the Department indicates that the appropriate adjustment to test year expense for the amortization of the PBR proceeding expenses is an increase of $102,254. On Schedule 2 of the Order, however, the figure listed is $100,443. The figure in the text of the Order is the correct one.

Q. Does the Company request reconsideration of the amortization period allowed for the Company's QUEST cost?

A. Yes, it does. On page 56 of the Order, the Department held that the proper amortization period for the Company's $7.7 million QUEST costs was the five year span of the PBR plan. We would ask that the Department reconsider this aspect of its decision, particularly in

light of the evidence I submitted in the initial hearings in support of a two year amortization period, to the effect that our ability to succeed under PBR will require future reengineering efforts. Exh. DPU-118. Because that analysis was not cited in the Department's decision, we are concerned it may have been overlooked. Additionally, the Company would point to the NYNEX decision, D.P.U. 94-50 (1995) which specifically authorized a two year amortization period for that Company's $332 million Process Reengineering Plan. Boston Gas believes it is entitled to consistent treatment. The Department's five year amortization period inappropriately penalizes the Company and serves as a disincentive for future cost-cutting programs such as QUEST. We ask that the Department reconsider, and allow the two year amortization period proposed by the Company.

Q. Did the Department err in calculating the Company's pension expense?

A. Yes, it did. In disallowing the 1996 system renewal investments and the 1996 performance measurement systems, the Department questioned the reliability of forecast information. Yet in its calculation of the Company's average pension contribution, it included the 1996 forecast contribution amount of $0. Although that forecast was prepared by the Company's actuaries (Mercer and Co.),

it is not "known and measurable." Quite the contrary, it is subject to change up to nine months after the end of the year, as evidenced by the change in the 1995 forecast. In 1995, the original tax deductible contribution calculated by Mercer was $2,684,388. Upon subsequent review, in August, 1996 the allowable tax deductible contribution was increased to $7,981,179, a change of nearly $5.3 million.

The Department accepted the Company's calculation of public liability expense (Exh. BGC-39, p. 26) which was based on the average cash payments for the last five years (1991-1995). The Department should employ consistent methodology in the calculation of the Company's pension expense and determine the average of the known and measurable cash contributions made for the 1991 through 1995 tax years. This calculation results in an allowable pension expense of $1,878,929, or an adjustment to the Company's cost of service of $752,983. Exh. BGC-276.

The Department based its allowable pension expense on the average cash contributions, yet then netted these amounts against the average annuity gains over the five year period. These gains should not be included in the calculation as they only impact the Company's pension expense as shown on Exhibits AG-99 and DPU-200.

<u>**Q. Does the Company dispute the Department's decision to eliminate the FAS 106 phase-in adjustments for Post-Retirement Benefits other than Pensions (PBOPs)?**</u>

<u>**A. Yes, we do. In effect, what the Department has done in its Order is to substitute its judgment as to medical cost trend rates for that of the Company's actuaries, and arrive at a total PBOP expense of $6,774,709. In so doing, it specifically eliminated $2,569,231 of FAS 106 phase-in adjustments previously allowed in D.P.U. 93-60. Order, p. 86. The Company asks that the Department reconsider its decision to disallow the phase-in adjustments. The Company is entitled to "reasoned consistency" on the ratemaking items such as this, and further is entitled to rely on Department Orders that approve a particular course of conduct. Boston Consolidated Gas Co. v. Department of Public Utilities, 321 Mass. 259, 265 (1947).**</u>

<u>**Q. Does the Company dispute the Department's disallowance of the depreciation and amortization expense on its 1996 system renewal and performance measurement system investments?**</u>

<u>**A. Yes, it does. As I have already discussed, $28,056,000 of the system renewal investment and $1,582,000 of performance measurement systems should be included in the Company's test year rate base. The annual depreciation and amortization expenses associated with**</u>

these investments are $1,341,077 and $316,400, respectively.

Q. Please explain the Company's objection to the Department's computation of property tax expense.

A. In the Order, the Department said it was "unpersuaded" that the Company's personal property tax bill assessments are based on 100% of the net book value in each city and town. New evidence demonstrates that for the fiscal tax years 1992 through 1996, overall assessments average 99.85% of net book value. Exh. BGC-277. In addition, whereas only 48 cities and towns assessed at 95% to 105% of net book value in fiscal 1992, currently 73 of the 79 cities and towns now use net book value as the basis for their assessments. Moreover, the ratio of assessments to net book value has remained constant while the Company's net book value has increased by more than $114 million, or nearly 40 percent. Given the historical correlation between net book value and assessed amounts, the Company's proposed adjustment of $881,691 for personal property taxes resulting from the increase in its December 31, 1995 net book value should be considered as known and measurable and allowed by the Department.

Q. Is the Company requesting that the Department reconsider its decision to set the Company's return on equity at 11.0 percent?

A. Yes, it is. The Company is concerned that the Department did not fully consider the risk considerations of operating under a PBR environment and therefore did not incorporate the increased risk factors into the allowed cost of equity. As Paul Moul testifies, "while an 11% return may have been adequate under traditional cost of service/rate of return regulation, it is clearly inadequate [under PBR]." Exh. BGC-278. Mr. Moul also notes the potential impact on credit quality due to the 11% return on equity. The financial markets are also concerned about the Company's allowed return. Standard & Poor's recently noted that the Order "may adversely impact credit quality" and "put further pressure on Boston Gas' financial performance." (Exh. BGC-279) Merrill Lynch stated in a recent analysis of the Company that an 11.0% return on equity "does not appear competitive relative to other investment opportunities." Exh. BGC-280.

The Company believes that given the risks associated with PBR, and the fact that two other Massachusetts gas utilities were granted returns on equity of 11.25% and 11.19% under traditional cost of service settlements, an 11.0% return is inadequate for the Company to compete successfully under the new business environment. At a minimum, the Department should incorporate the 11.25% return on

equity approved in D.P.U. 93-60 and stipulated in the Company's settlement agreement of November 15, 1996.

Q. Does this conclude your analysis of the Company's rate base, operating expenses and revenues.

A. Yes, it does.

Q. Do you have any final comments?

A. Yes. The Company presented a cost of service analysis that was intended to incorporate traditional cost of service principles while at the same time recognizing the fact that certain issues special consideration as the Company transitions to PBR. The Department has approved the Company's move to PBR, yet has not recognized the need to review and update traditional cost of service principles. As testified by Mr. Messer, this failure has created an unfair financial burden on the Company, and the Company requests that the Department amend its original order to incorporate the adjustments I have discussed in my testimony. Exh. BGC-246.

Q. Does this conclude your direct testimony?

A. Yes, it does.

Boston Gas Company
D.P.U. 96-50
Exhibit BGC - 252
Witness: Lowry

Exhibit List

Reconsideration Testimony of Jane M. Kelly	BGC-264
Revised Cost of Service	BGC-265
1996 System Renewal Investments	BGC-266
Net Present Value - 1996 System Renewal Investments	BGC-267
Compas and Hyperion Performance Measurement Systems	BGC-268
Net Present Value 1996 Performance Measurement Systems	BGC-269
Department Precedent - Union Wage Increase	BGC-270
1997 Management Salary Increase - Commitment	BGC-271
Department Precedent - FICA increase	BGC-272
Overtime Analysis	BGC-273
Bad Debt Lagging Schedule	BGC-274
Cellular Phone Expense - 12 months Actual	BGC-275
Pension Expense	BGC-276
Personal Property Tax Expense	BGC-277
Return on Equity analysis - Paul Moul	BGC-278
Standard & Poors's post-Order Analysis	BGC-279
Merrill Lynch Post-Order Analysis	BGC-280

<u>**Boston Gas Company**</u>
<u>**Petition for Reconsideration**</u>
<u>**Exhibit BGC-281**</u>
<u>**Witness: William T. Yardley**</u>

<u>**Reconsideration Testimony of William T. Yardley**</u>

<u>**Q. Did you testify in the initial phase of D.P.U. 96-50?**</u>

<u>**A. Yes, I did. As Manager of Gas Acquisition and System Control, I testified as to the operational aspects of the proposed transportation tariffs for commercial/industrial customers, and the Company's proposal for assignment of upstream pipeline and underground storage capacity.**</u>

<u>**Q. What is the purpose of your reconsideration testimony?**</u>

<u>**A. The purpose of my testimony is to explain the need for additional clarity in the Department's Order requiring the Company to provide transportation customers with access to downstream assets. If it is the Department's intent to require that the Company fully unbundle**</u>

its downstream assets, then my testimony provides evidence not available to the Department in Phase I of this proceeding. This evidence would have had a substantial effect on the Department's decision. To summarize, it is operationally infeasible for the Company to allocate downstream assets in a manner consistent with its assignment of upstream capacity without placing severe restrictions on how third parties are allowed to use these assets. Such restrictions would simulate how the Company, as system operator, would utilize these resources. Unless the system operator remains in control of the facilities, its ability to provide safe and reliable service would be threatened.

Q. Please define downstream assets and identify the downstream assets owned by the Company.

A. In the context of my testimony, downstream assets refer to the Company's liquefied natural gas (LNG) facilities and propane/air (LPA) facilities. The Company operates LNG facilities at three locations in its service territory: Dorchester, Salem, and Lynn. The Company operates LPA facilities at nine locations in its service territory: Everett, Leominster, Southbridge, Norwood, Danvers,

Gloucester, Reading, Revere, and Spencer.[37]

Q. Please explain how the Company uses its downstream assets.

A. The Company uses its downstream assets on those critically cold days during the heating season when supplies provided by the interstate pipeline are insufficient to meet the requirements of its customers. These facilities are also used to maintain balance on the Company's system while keeping hourly takes at the city gate stations in compliance with the pipeline tariffs and to maintain system pressures in those areas of its distribution system where there is limited capacity during peak periods. Finally, LNG and LPA facilities are available to temporarily meet system requirements in the event of an emergency pipeline curtailment or interruption, to the extent inventories at the time allow.

Q. What is involved in managing downstream assets?

A. There are several management functions related to downstream assets. The most critical is to ensure that sufficient inventory is

[37] **See, exhibit DOER-1 for a listing of the Company's downstream facilities and their capacity capabilities. The Company notes that its Braintree LPA facility has been retired.**

available at the beginning of each heating season to meet the requirements of the distribution system and, that as inventory is utilized, sufficient inventories and/or re-gasification opportunities remain to meet forward-looking requirements through the peak season.

The system operator must have the capability to dispatch at will the necessary downstream resources to maintain adequate pressure levels across its system, particularly in geographically isolated portions of the system. The Company's downstream facilities are strategically located within the service territory, for there are recurring circumstances under which they must be run to maintain deliverability.

Finally, from a safety perspective, the system operator must closely monitor the quality (thermal content and gravity) of the LNG delivered to its facilities for storage and re-gasification. This is necessary to ensure compatibility with currently stored liquids and to prevent stratification which could result in structural damage to the tanks.

Q. In light of the Company's responsibilities as system operator, what

operating restrictions would you need to place on allocated downstream assets to ensure system integrity?

A. Unlike upstream pipeline capacity or underground storage, opportunities to replenish liquid inventories are limited during the heating season. If such inventories are expended for purposes other than to meet the customers' peak needs, then curtailment of service is the only option to maintain system integrity. To ensure system integrity without resorting to curtailment, the Company would need to place strict operating requirements on third party access to the facilities. This would include a requirement that third party suppliers maintain minimum inventory levels during peak and off peak seasons, and that the Company retain the right to require suppliers to refrain from using downstream supplies at certain times and to mandate that they be dispatched at other times. Essentially, this would result in suppliers being able to utilize LNG and LPA only during those periods when the Company would have used them. As system operator there would be no other way to guarantee system integrity.

Furthermore, the Company would need to purchase or develop an inventory management system to track the inventory level of each

supplier holding capacity in the Company's facilities, and an accounting and billing system to ensure, amongst other requirements, that third parties who deliver replacement supplies that require conditioning prior to being introduced into the system are properly allocated those costs.[38]

Q. Under what circumstances might a third party supplier seek to utilize downstream capacity other than to meet their on-system customers' peak requirements?

A. The cost of the Company's LNG and LPA capacity would be known and quantifiable. Absent the operating restrictions I just mentioned, any time pipeline capacity in a service territory upstream from the Company was commanding a higher price than LNG or LPA, a supplier would have an economic incentive to divert pipeline capacity and utilize the Company's downstream assets for its Boston Gas customers. This could be done regardless of the availability of pipeline capacity to Boston. The Company would have no assurance that the LNG and LPA inventory could then be replaced and available for peak system requirements, which could

[38] Re-gasified liquid may require air stabilization, due to high thermal conduct, to ensure an interchangeable gas supply and proper combustion.

have catastrophic implications.

Furthermore, shortages caused by severe winter weather, such as were experienced last winter, could drive the price of LNG up, providing an incentive for supplier's to divert their allocated inventory of LNG to the highest bidder. Perversely, if this caused critical shortages on the Company's system, the Company could be forced to bid a higher price for the same capacity that it had allocated to its customers at cost, just to maintain the integrity of the system.

Q. Do customers currently have access to the Company's downstream resources?

A. Yes. Sales customers have access to these resources through the bundled nature of the Company's sales service. Under the transportation tariffs approved in Phase I, those customers who elect General Transportation service will continue to have access to these resources and related services through the Company's balancing service.

Q. Are there competitive alternatives to the Company's balancing

service in the marketplace?

A. Yes. There are a number of ways a customer could implement self-balancing options. For example, a customer could arrange for additional upstream capacity to be available during peak periods to allow delivery of its full requirement on any day. If a customer is part of a broker supply pool and the pool contains dual fuel capability, arrangements can be made among the pool participants to exchange volumes during peak periods. Finally, a customer could arrange for a peaking service from a supplier, such as Distrigas, who can either make deliveries directly into the Company's distribution system or arrange for deliveries through the interstate pipeline to the appropriate receipt point for transportation to the customer.

For these options to be available to customers, an alternative to remote meter reading must be implemented. The Department recognized this in its Order and directed the Company to develop a sendout formula-based approach for determining a customer's daily delivery requirement on a pilot basis within six months of the Order. At that point, customers will have a genuine choice whether to purchase access to the Company's downstream assets at cost or to purchase a competitive alternative.

Q. Does this conclude your testimony?

A. Yes.